

INDIVIDUAL RETIREMENT ACCOUNTS (IRA's) IN THE RETIREMENT SYSTEM

HEARING BEFORE THE SUBCOMMITTEE ON SELECT REVENUE MEASURES OF THE COMMITTEE ON WAYS AND MEANS U.S. HOUSE OF REPRESENTATIVES ONE HUNDRED TENTH CONGRESS SECOND SESSION

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**INDIVIDUAL RETIREMENT ACCOUNTS (IRA's)
IN THE RETIREMENT SYSTEM**

THURSDAY, JUNE 26, 2008

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON SELECT REVENUE MEASURES,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:05 a.m., in room 1100, Longworth House Office Building, the Honorable Richard E. Neal [Chairman of the Subcommittee] presiding.
[The advisory of the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON SELECT REVENUE MEASURES

FOR IMMEDIATE RELEASE
June 19, 2008
SRM-10

CONTACT: (202) 225-5522

Neal Announces Hearing on Individual Retirement Accounts (IRAs) and their role in our retirement system

House Ways and Means Select Revenue Measures Subcommittee Chairman Richard E. Neal (D-MA) announced today that the Subcommittee on Select Revenue Measures will hold a hearing on the role of Individual Retirement Accounts (IRAs) in our retirement system. **The hearing will take place on Thursday, June 26, 2008, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.**

Oral testimony at this hearing will be limited to invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

FOCUS OF THE HEARING:

The hearing will focus on the recently issued report by the Government Accountability Office (GAO), entitled *Individual Retirement Accounts, Government Actions Could Encourage More Employers to Offer IRAs to Employees*, June 2008; the role of IRAs in our retirement system; and legislative proposals for automatic IRA enrollment.

BACKGROUND:

More than 30 years ago, Congress created IRAs to provide workers not covered by a pension plan with an option to save for retirement. The need for workers to preserve their retirement savings when they change employment was the basis for further Congressional action utilizing IRAs in a worker's ability to roll over savings from an employer-sponsored plan. This rollover option accounts for the majority of assets held in IRAs.

In addition, Congress has used IRAs as an incentive for small employers to provide retirement plans for their workers. In 1978, the Simplified Employee Pension (SEP) was created. Under a SEP, an employer with 25 or fewer eligible employees can establish an IRA for each eligible employee. Salary reduction contributions are made to the IRA on the employee's behalf. Another option for small employers is the Savings Incentive Match Plan for Employees (SIMPLE), created in 1996. Under a SIMPLE, employers with 100 or fewer employees can establish an IRA for each eligible employee. The employee makes elective deferrals to the IRA and the employer makes certain matching contributions. There is also the payroll deduction program which allows the employer to make payroll deductions which are contributed to an IRA established by the employee. These various types of IRAs are in addition to traditional IRAs and Roth IRAs. Traditional IRAs allow eligible individuals to make tax-deductible contributions to the account, and investment earnings accumulate on a tax-deferred basis. Certain income limits apply and distributions are taxable. The Roth IRA allows eligible individuals to make after-tax contributions

with generally tax-free investment earnings. Certain income limits apply and distributions are tax-free.

In announcing the hearing, Chairman Neal stated, **"I have always been a strong advocate for creating retirement savings opportunities for every American. That is why I have introduced legislation, along with several co-sponsors, to create automatic payroll deposit IRAs for workers who do not have access to employer-sponsored pension plans. The bill would require employers to automatically enroll employees in a payroll deduction IRA unless the employee opts out. Our proposal could raise the national savings rate by nearly \$8 billion annually. This hearing will explore these ideas along with other issues related to IRAs."**

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit testimony for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, <http://waysandmeans.house.gov>, select "110th Congress" from the menu entitled, "Committee Hearings" (<http://waysandmeans.house.gov/Hearings.asp?congress=110>). Select the hearing for which you would like to submit, and click on the link entitled, "Click here to provide a submission for the record." Follow the online instructions, completing all informational forms and clicking "submit" on the final page. **ATTACH** your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business **Thursday, July 10, 2008. Finally**, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225-1721.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and **MUST NOT** exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at <http://waysandmeans.house.gov>

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman NEAL. Let me call this meeting to order. I hope that our guests would take their seats. I want to welcome everyone to this hearing on the role of Individual Retirement Accounts, or IRAs, by the Subcommittee on Select Revenue Measures.

By way of introduction, I think that my bipartisan credentials on this issue have been pretty sound. I incurred, as a young Member of this Committee many years ago—let's put it this way. I increased my name recognition with Chairman Rostenkowski in my push to expand IRA limits. At that time, his argument was fairly simple, and it's still something we need to be mindful of, making sure that the basis of the IRA is not just to allow wealthy people to save more.

At the same time, I worked with the former Chairman of this Committee, before he was the Chairman, to expand IRA limits. We had a great deal of success back in the mid-1990s.

You have all probably heard of the three-legged stool meant to prop up retirees in their golden years. That is Social Security, pensions, and savings. Today we will be discussing personal savings, and why the national savings rate continues to decline. As you can see from the slide I hope will be displayed as I speak, our personal savings rate has declined over the decades to a paltry one-half of 1 percent since 2005.

IRAs have existed for decades now with the hopes that those without employer plans would save on their own. Yet, we are still faced with under-utilization by the intended targets. GAO recently projected that 37 percent of all workers will retire with 0 plan savings. That of young and low income workers, 63 percent will have no plan savings at retirement.

Clearly, we must do more to foster personal savings. We must begin to think more creatively, and use innovation to capture this group of workers who are not saving. One of the vehicles is the auto-IRA, which Mr. English and I have sponsored here in the House. I really think that this could get done next year.

With 75 million workers with no access to a workplace retirement plan, and only 10 percent of these workers saving on their own, clearly the current incentives are not working. Today's hearing will explore these issues and other ideas to reach out to those who should be saving more.

As George Foreman observed—and I quote—"The question isn't at what age I want to retire, it's at what income." If only we all had this same observation in our twenties, we wouldn't be fighting so hard to save in our fifties.

With that, I recognize my friend, Mr. English, for his opening statement.

Mr. ENGLISH. Thank you, Mr. Chairman. Mr. Chairman, I find myself entirely in agreement with the thrust of your remarks. I want to express my gratitude to you for having this hearing, and creating an opportunity to build toward an expansion of IRAs, and potentially the addition of the auto-IRA, which I have been privileged to join you in sponsoring in the House of Representatives.

The issue of improving our retirement savings system is one that certainly lends itself to bipartisanship. It is particularly important to me, as co-Chairman of the Congressional Savings and Ownership Caucus. Clearly, we need to do more to encourage all Ameri-

cans to save for retirement. We need to work together to find creative solutions.

The U.S. retirement savings system has been described by many, as well as yourself, Mr. Chairman, as that three-legged stool, with Social Security, employer-based retirement plans, and personal savings constituting each of those legs.

The first leg, Social Security, covers workers on a near universal basis. But the benefits of the program are limited by statute. The system itself faces significant financial challenges over future decades, due to changes in demographics.

The second leg, employer-based retirement savings plans, includes both traditional defined benefit pension plans, and more recently established defined contribution arrangements, such as the now-familiar 401(k) plan. Such employer-based plans are estimated to cover only about one-half of the workforce. Although three-quarters of the workers whose employers currently offer such a plan do participate in it, an estimated 75 million American workers are employed by businesses, typically small businesses, which do not offer such a plan.

The third leg of the retirement stool is personal savings. Unfortunately, the personal savings rate, which averaged about 9 percent during the 1960s, 1970s, and 1980s, now has been on steady decline for a generation. Alarming, the personal savings rate has been less than one percent in every quarter since 2005. This constitutes a quiet crisis that is a core challenge to the competitiveness of our economy.

Congress has enacted numerous tax incentives over the past several decades designed to encourage retirement savings, both through employer-based plans, and through individually owned savings plans. This hearing will focus on one such set of retirement savings vehicles: in particular, IRAs.

IRAs were first created in their traditional form in 1974, and they have been expanded repeatedly since. As we're going to hear from our witnesses today, these savings vehicles play a significant role in the U.S. retirement system. More assets are held in IRAs than any other type of retirement savings arrangement, including 401(k) plans.

Due to ongoing concerns regarding the retirement savings patterns of Americans, especially among low and middle-income individuals, I have been excited to pursue proposals to expand IRAs, particularly, Mr. Chairman, your proposal to create an automatic IRA. Building on the success of similar initiatives, I believe this tool has the potential to fundamentally expand savings opportunities for millions of Americans, and generate billions of dollars in new savings.

Mr. Chairman, I look forward to hearing from the distinguished panels that you have arranged for this morning, and I am hopeful that their testimony will help us develop creative solutions—and I hope also, a groundswell of support in the House for the initiative you have outlined. Thank you very much.

Chairman NEAL. Thank you, Mr. English. Consistent with that principle of the distinguished, we have two Members of the Committee, Mr. Kind and Mr. Hulshof, and together they will advocate for legislation modifying SIMPLE plans.

On our second panel, we will hear from government witnesses, starting with Mrs. Barbara Bovbjerg, the Director of Education, Workforce, and Income Security Issues at the GAO. Next, we will hear from Mr. Tom Reeder, the Benefits Tax Counsel in the Office of Tax Policy at the Treasury Department. Then we will hear from Mr. Bradford Campbell, the Assistant Secretary in the Employee Benefits Security Administration at the Labor Department.

Our third panel will allow us to welcome a number of witnesses from the private sector, beginning with Dr. Leo Estrada, a board member of AARP, and a Professor of Urban Planning at UCLA. We also will welcome Mark Iwry, who is a fellow at the Brookings, a Professor at Georgetown, and a Principal at the Retirement Security Project, but still finds time to share his thoughts this morning with the congress.

Next we will hear from Mr. Dallas Salisbury, the President and CEO of the Employee Benefit Research Institute. We also welcome Ross Eisenbrey, Vice President for the Economic Policy Institute. Finally, we will welcome Randy Hardock of Davis & Harman, who will be testifying on behalf of The Savings Coalition of America, whom, I might point out, I worked with back in the early and mid-1990s.

Without objection, any other Members wishing to insert statements as part of the record may do so. All written statements written by the witnesses will be inserted into the record, as well.

I recognize Mr. Kind.

STATEMENT OF THE HONORABLE RON KIND, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN

Mr. KIND. Thank you, Mr. Chairman, and Ranking Member English, Members of the Committee. It's kind of fun to be on this side of the table, isn't it Kenny, for a change?

But we really appreciate the opportunity to testify today. I think both you and Mr. English teed up the issue very, very well. I couldn't be more supportive of the proposal of automatic IRA legislation that you have introduced.

I think one of the best things we did with pension and reform legislation a few years back was call for automatic enrollment of 401(k)s, because we all know one of the greatest obstacles to increase individual savings in this country is, quite frankly, inertia, just getting people to do something. So, automatic enrollment, I think, would be a tremendously helpful and beneficial step to try to increase the individual savings rate.

But you have both highlighted what the problem is. We have an effective zero percent on an individual savings rate right now in the country. You couple that with the bad savings on the public ledger side of things, too, and all three legs of the retirement savings stool is in great jeopardy today.

We know we have some long-term fiscal challenges dealing with the solvency of social security. We have had a dramatic decline in defined pension plans throughout the country, from roughly 65 percent from 1979 to a little bit under 10 percent today. We are not doing enough, I feel, to encourage and incentivize greater individual savings opportunities for employees throughout the country.

But as Mr. Hulshof and I were looking into this, there was a real glaring hole out there that we felt needed to be addressed, and that was the savings options or opportunities for employees in small businesses. Because today there just isn't a lot of participation along these lines, even though back in 1996—as this Committee is well aware—with the creation of SIMPLE 401(k)s and SIMPLE IRAs, it was meant to get at this pool of workers to make it easier for them to set up their own savings.

Now, here we are, 12 years later, there really hasn't been any reform or changes or modifications based on what we have learned. We have learned a lot during that time: the fact that there aren't that many plans still being offered, because in most instances for small employers, it's either too complicated, too costly, or there is—it's a somewhat risky endeavor. That was the impetus behind the legislation that we have introduced, H.R. 5160, or The Small Business Add Value for Employees Act, the SAVE Act. I thank Mr. English for being one of the original cosponsors on the legislation, as well.

With your insistence, Mr. Chairman, what's helpful is the recent GAO report that came out this month. The recommendations that they're making is very consistent with many of the proposals that we're offering in this legislation, to try to increase and incentive the opportunities for employers to offer IRA savings opportunities for more employees, because the numbers are very stark.

Today we know that only 14 percent of small businesses offer a 401(k) plan; 63 percent of small businesses throughout the country offer no savings option at all to their employees. That's roughly 71 million workers in small businesses that don't have a plan that they can participate in, even if they wanted to. That's a lot of people who are being left behind, and perhaps the most vulnerable population that we have, when it comes to retirement security and needs.

But let me just quickly and briefly summarize what the legislation would try to address, both the complexity, the cost, and some of the risky endeavors that small employers are facing.

We are trying to increase flexibility for employers under the legislation, and it would remove the requirement that SIMPLE IRA plans operate only on a calendar year basis. Authorizing small businessowners to make mid-year changes to their SIMPLE plans ensures that businessowners need not wait until the beginning of the year to move to a new retirement plan.

The SAVE Act also would change outdated SIMPLE IRA rules that unnecessarily restrict an employer's ability to contribute to the employee savings. Under current law, the employer is not permitted to match more than three percent of the employee's salary, and make more than 2 percent non-elective contribution to workers' accounts. The SAVE Act would remove this restriction, and allow employers to make additional contributions to all participants' accounts.

We are also trying to increase incentives for employers to just offer more SIMPLE IRAs to their employees. The Act would make a number of important reforms with this goal.

First, it would create a new automatic IRA option under the Internal Revenue Code. Although we still leave it discretionary with

the employer, whether they want to have an automatic enrollment—and I think that’s something we can have a further conversation about, as far as modifying the legislation that we’re offering—automatic IRAs would provide a relatively simple and cost-effective way to increase retirement security for those 71 million employees who sometimes aren’t taking steps in order to increase their own savings.

Also, the SAVE Act would increase the small employer pension plan startup cost credit for small businessowners to 50 percent of the startup cost. This, again, is consistent with some of the findings of that GAO report that just came out this month.

It would also allow a one-time \$25 tax credit for every new employee who is enrolled in the savings program.

Finally, it increases incentives for employees to participate in SIMPLE IRA plans, and would update the annual contribution limits. Employees covered under the 401(k) plans today are permitted to save up to \$15,500, annually. But small business employees can only save \$10,500 annually, under a SIMPLE IRA. We’re just bringing that to parity, and we see no reason why there is a distinction or discrimination with SIMPLE IRAs, given the contribution limits of 401(k)s.

So, we think, you know, this legislation, if we can move it forward in a bipartisan fashion, I think addresses the interests and the concerns that you, Mr. Chairman, and Mr. English, and others on the Committee are trying to get at through this hearing and through important legislation that you have addressed.

We are trying to reach those 71 million or so employees in small businesses that don’t have an opportunity to save, while addressing some of the concerns and feedback that we were getting from small business employers throughout the country—cost, complexity, some of the risks involved—through the incentives that we have built into this legislation.

So, thank you again for the opportunity to testify today. We look forward to working with you and others on the Committee to move forward on this. Thank you.

[The prepared statement of the Honorable Mr. Kind follows:]

**Statement of The Honorable Ron Kind,
a Representative from the State of Wisconsin**

Chairman Neal, Ranking Member English and other Members of the Subcommittee, thank you for the opportunity to testify today.

As a first term Member of the House Ways and Means Committee, I decided early on to focus much of my work on issues and concerns relating to small businesses. I did this for the simple fact that my district has a large number small businesses. In fact, Wisconsin as a whole has 447,000 small businesses which employ a higher than national average of 54 percent of the workforce.

Earlier this year I held several small business forums in my district where I continuously heard that retirement and savings issues were a top concern. As I dug into the issue I discovered that the majority of small businesses don’t offer any retirement savings plans to employees because it is often a complicated, costly, and a somewhat risky endeavor.

Small business owners often wear multiple hats and simply do not have enough time and resources to devote to administering a complicated financial product. According to a survey of small businesses conducted by Harris Interactive, only 14 percent of small businesses offer a 401(k) plan and 63 percent do not offer any form of retirement benefits at all.

That is why I, along with my friend and colleague Rep. Kenny Hulshof, introduced H.R. 5160, the Small Businesses Add Value for Employees (SAVE) Act of 2008, to

make several enhancements to the existing SIMPLE IRA and SIMPLE 401(k) retirement plans. These changes are supported by many in the small business community and the retirement industry in general as common sense approaches to encourage small business owners to offer savings plans to their employees.

As you may know, SIMPLE IRA and SIMPLE 401(k) plans were created in 1996 to address the need for an easy way to administer savings plans for small businesses of 100 employees or less. Since 1996, thousands of small businesses have taken advantage of the new plans, with almost 2 million workers now covered by a SIMPLE IRA.

Very little modifications have been made to the SIMPLE IRA since it was first created. On one hand, this is a good thing since we do not want to discourage small employers by constantly tinkering with the mechanics of the program, making it more costly to administer. On the other hand, after over ten years of operation, I do think the SIMPLE IRA is ready for some modernization.

The SAVE Act would help accomplish this goal by helping minimize the barriers to small business retirement plan sponsorship through a number of important changes:

To increase flexibility for employers, H.R. 5160 would remove the requirement that SIMPLE IRA plans operate only on a calendar year basis. Authorizing small business owners to make mid-year changes to their SIMPLE plans ensures that business owners need not wait until the beginning of the year to move to a new retirement plan.

The SAVE Act also would change outdated SIMPLE IRA rules that unnecessarily restrict an employer's ability to contribute to their employees' savings. Under current law, an employer is not permitted to match more than 3 percent of the employee's salary or make more than a 2 percent nonelective contribution to workers' accounts. H.R. 5160 would remove this restriction and allow employers to make additional contributions to all participants' accounts.

To increase incentives for employers to offer SIMPLE IRAs, the SAVE Act would make a number of important reforms. First, the SAVE Act would create a new Automatic IRA option under the Internal Revenue Code. Automatic IRAs would provide a relatively simple and cost-effective way to increase retirement security for the estimated 71 million workers whose employers do not sponsor plans. The Automatic IRA option would be voluntary on the part of the small business owner, but would require participating owners to automatically enroll employees in the plan.

- Second, the SAVE Act would increase the *Small Employer Pension Plan Start-up Cost Credit* for small business owners to 50 percent of the start-up costs for new SIMPLE IRA plans and would allow for a one-time \$25 tax credit for every new employee who is enrolled in the savings program.

Lastly, to increase incentives for employees to participate in SIMPLE IRA plans, the SAVE Act would update annual contribution limits. Currently, although employees covered under a 401(k) plan are permitted to save up to \$15,500 annually, a small business worker can save only up to \$10,500 annually in a SIMPLE IRA. I see no reason to continue a policy that discriminates against small business owners, particularly at a time when we are trying to encourage Americans to increase their personal savings.

In conclusion, Chairman Neal, I greatly appreciate the opportunity to testify today and to highlight this important legislation to improve the rules that govern SIMPLE retirement plans. Larger pools of savings will have positive benefits for economic growth. By encouraging savings, the amount of capital available for investment will increase, which is a primary source of job creation and worker productivity. I look forward to working with you and the other Members of the subcommittee to see these and other important reforms enacted.

Chairman NEAL. Thank you, Mr. Kind.
Mr. Hulshof.

STATEMENT OF THE HONORABLE KENNY C. HULSHOF, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSOURI

Mr. HULSHOF. Thank you, Mr. Chairman. As you made your opening statement, you referenced a former Chairman of this Committee, Mr. Rostenkowski. Note, as he gazes down upon us, the

trace of a smile on his portrait. I'm sure he was recognizing the wisdom that you had regarding IRAs at an early time on this Committee. I am certain that that's why he has such a pleasant expression.

Chairman NEAL. I also will assure you he still remembers—
[Laughter.]

Mr. HULSHOF. You and I, Mr. Chairman, have had the opportunity to respectfully discuss, perhaps debate, in a number of arenas. I remember in the Rayburn hearing room on Social Security we talked about the challenges of solvency, and the timing, and the eminence of those. I think you have adequately touched on that, as has my friend, Ron.

The first baby boomer began to retire on January 1 of this year. If tradition holds, one out of every 2 senior citizens at the age of 62 will opt out for early retirement. So, whether that number continues to hold, or whether they continue to stay strong in the work force, we don't know. But, obviously, time is of the essence, as we look at what can we do for this arena of retirement.

Now, I think we should also highlight the fact that this Committee has distinguished itself over the course of years of working in a bipartisan way to address the pension challenges. Our former colleague, Mr. Portman from Ohio, our former colleague, Mr. Cardin—now in the other body—from the State of Maryland did some tremendous work in the whole areas of pension, especially as we began to move the discussion away from defined benefits to defined contributions.

So, this Committee has a great record, I think, as far as helping prepare for those golden years. I am not sure that Kind-Hulshof will roll off the tongue, or be as significant as Portman and Cardin, but nonetheless, we're here because we think that we are on the right track.

In fact, as—we had these discussions before the GAO report really came out, and we saw that we were at least on the same page in many of these important aspects as far as providing some updates to the SIMPLE plans, and I think Ron has touched on them fairly significantly.

If I were to summarize what we hope to accomplish by the SAVE Act, it would simply be flexibility and portability. As Ron talked about, the flexibility for small businesses, you know, some of these are—in fact, I'm not quite sure even—that there were these obstacles in place, but we have seen now—and as Ron pointed out, but as I would also cite—that in a 2005 publication of the Investment Company Institute's perspective, the number of SIMPLE IRA plans had been growing at an average of about 25 percent per year between 1998 and 2003. But we want to expand those opportunities, and providing flexibility for small businesses is a way to do that.

On the other end of it, though, for the employee, portability. You know, again, we are such a mobile work force, that having the opportunity, then, to have universal portability by allowing rollover assets into other qualified plans I think is another feature of our bill that should enjoy some pretty strong support.

You know, our Nation, Mr. Chairman, was built on the backs of able and willing entrepreneurs who, with a little faith and a lot of ingenuity, started businesses in the hopes of achieving the Amer-

ican dream. These small businesses have been enormously successful, and of course, drive our National economy to the greatest degree. They have to surpass numerous hurdles to making those businesses survive and grow.

Of course, attracting the most talented, bright workers to participate in that American dream, attracting those employees is crucial to their growth, and offering the employer-sponsored retirement plans such as a SIMPLE IRA or 401(k) certainly helps that goal.

So, I would like to thank my friend from the State of Wisconsin for his willingness to yet again reach across the aisle, and for us to have the opportunity to work together. Thank you, Mr. Chairman, for giving us this opportunity for a hearing to highlight some of the things that we think would move us forward, as far as providing more flexibility and portability in the pension arena.

[The prepared statement of the Honorable Mr. Hulshof follows:]

Statement of The Honorable Kenny Hulshof, a Representative in Congress from the State of Missouri

Testimony Before the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means

June 26, 2008

Chairman Neal and Ranking Member English, I would like to thank you for the opportunity to testify before the subcommittee regarding the importance of Individual Retirement Accounts (IRAs) in retirement planning. Today, I would like to focus my testimony on Savings Incentive Match Plans for Employees, more commonly known as the SIMPLE IRA and 401(k) plan.

As many of you know, the SIMPLE IRA and 401(k) plan were established in the Small Business Job Protection Act of 1996. Building upon and replacing the Salary Reduction Simplified Employee Pension IRA (SAR-SEP IRA), SIMPLEs were crafted to help small businesses provide their workers with a straight forward and easily understood retirement plan without all the trappings associated with other employer sponsored plans, such as a traditional 401(k) plan.

To qualify, a small business must have 100 employees or less and cannot offer any other retirement plan. SIMPLE plan participants are able to contribute up to \$10,500 a year with employers providing either a matching contribution of up to 3% of compensation or a 2% non-elective contribution. Plan participants are fully vested in these contributions and can make penalty free withdrawals after the age of 59 and a half.

In the 12 years since its inception, participation in SIMPLE IRAs has steadily grown. In a 2005 publication of the Investment Company Institute's Perspective, it was noted that the "number of SIMPLE IRA plans grew an average of 25 percent per year between 1998 and 2003." Today, nearly 2 million employees are currently participating in either a SIMPLE IRA or 401(k) plan.

It is quite clear that SIMPLEs have proven to be a valuable retirement tool, but obstacles remain and we can clearly do more to make these plans more appealing to small businesses. To help increase participation in SIMPLE IRAs and 401(k) plans, I have partnered with my friend and colleague, Rep. Ron Kind, to introduce H.R. 5160, the Small Businesses Add Value for Employees Act or the SAVE Act of 2008. I am proud to be an original cosponsor of this legislation, which will expand and modify SIMPLE IRAs and 401(k) plans.

As we have already heard from Congressman Kind's testimony, H.R. 5160 will increase employee contribution levels to \$15,500 – the same as traditional 401(k) plans, eliminate the burdensome 25% penalty for withdrawals in the first two years of plan participation, and expand the Small Employer Pension Plan Start-up Cost Credit.

Our proposal will allow employees to reap the benefits of prosperous times by permitting small businesses to make additional non-elective contributions of up to 10% and will provide SIMPLE plan participants portability by allowing them to rollover assets into other qualified plans.

Lastly, the Kind-Hulshof proposal will provide small businesses flexibility in terms of plan administration by permitting them to terminate a SIMPLE plan mid-year instead of at the end of the calendar year. Small businesses face day-to-day challenges in their quest to remain competitive and economically viable. If a small business owner needs to terminate a plan or wishes to upgrade to a traditional 401(k) plan for example, we see no reason why he or she should be forced to wait until the end of the year.

We, along with the National Federation of Independent Business (NFIB) and the Securities Industry and Financial Markets Association (SIFMA), believe these changes will coax more small businesses into establishing SIMPLE IRAs and 401(k) plans as well as increase employee participation.

Encouraging individuals to save and invest for their retirement should be one of the highest priorities for not only this subcommittee or even the Ways and Means Committee but for this entire Congress. Toward this aim we can certainly be doing more. Unfortunately, many Americans do not have the ability to participate in an employer sponsored retirement plan and if they do, are not taking full advantage of it.

I am well aware of the Chairman and Ranking Member's proposal to create automatic IRAs to help provide employees without an employer sponsored retirement plan an option for saving. I would like to point out that the SAVE Act contains a similar provision that would create voluntary automatic IRAs to promote savings at small businesses currently lacking retirement plans.

Our nation was built on the backs of willing and able entrepreneurs who, with a little faith and help, started their own business in hopes of achieving the American dream. These small business owners have surpassed numerous hurdles to making their businesses survive and grow. Attracting bright, talented employees is crucial to small business growth and offering an employer sponsored retirement plan, such as a SIMPLE IRA or 401(k) plan, certainly helps this goal.

In closing, I would like to commend Congressman Kind for his leadership in improving SIMPLE IRAs and 401(k) plans and look forward to working with all of you to advance proposals that will help increase retirement savings. Thank you once again for the opportunity to testify.

Chairman NEAL. Thank you both for your very sound testimony. Are there questions of our two panelists?

The gentleman from California, Mr. Thompson, is recognized.

Mr. THOMPSON. Thank you, Mr. Chairman. I don't have a question, I just want to thank both of you for being here today. This is an extremely important issue for all of our constituents in all of our districts. We need to do everything we can to make sure that people are prepared and have the retirement—the financial retirement—security they need in order to live a gainful life during those retirement years. So, thank you very much.

Chairman NEAL. We thank you both for your testimony.

Mr. THOMPSON. Thank you, Mr. Chairman.

Chairman NEAL. Could we have the next panel? Ms. Bovbjerg, are you ready to proceed?

Ms. BOVBJERG. Yes, Sir, I am. Thank you.

Chairman NEAL. Please.

STATEMENT OF BARBARA BOVBJERG, DIRECTOR, EDUCATION, WORKFORCE AND INCOME SECURITY ISSUES, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Ms. BOVBJERG. Mr. Chairman, Members of the Subcommittee, I am really pleased to be here today to speak about Individual Retirement Accounts, and their role in retirement saving.

Congress created IRAs in 1974 to help build and preserve retirement savings, and over time, has developed a variety of these accounts, including the traditional IRAs, Roth IRAs, and several types of workplace-based IRAs, such as SIMPLE IRAs, SEPs, and payroll deduction IRAs.

My testimony today focuses on: the role of IRAs in retirement saving; the prevalence of workplace-based IRAs and the barriers that limit access to them; and finally, the ways that government agencies can help. My statement is based upon a report we issued recently for Ways and Means on this topic.

First, let me speak on the role of IRAs. Although intended to generate, as well as preserve retirement savings, IRAs today gain most of their assets from transfers—we call them rollovers—from other retirement accounts, such as 401(k)'s. Between 1998 and 2004, over 80 percent of funds flowing into IRAs came from other accounts. This means IRAs are an effective and important means to preserve retirement assets already saved, but play a significantly smaller role in building such savings.

Also, IRA ownership is limited, and is skewed toward households with relatively high earnings levels and educational attainment. In other words, people who have resources are more likely to have IRAs than people who do not.

Those who own IRAs are more likely to have traditional IRAs, set up by individuals on a tax-deferred basis. A smaller, but growing, number of people hold Roth IRAs, in which individuals make aftertax contributions, but take tax-free distributions in the future.

I would like to turn now to IRAs offered through the workplace. To address the issue of low retirement plan sponsorship among small employers, Congress created SEP and SIMPLE employer-sponsored IRAs. Labor also issued a regulation under which an employer could, without being considered a plan sponsor under

ERISA, maintain a payroll deduction program for workers to contribute to IRAs.

Individuals are thought to be more likely to save for retirement if payroll deduction and other workplace arrangements are available to make saving easy and routine, and the limited regulation of these types of IRAs is designed to encourage employers to offer them.

But such arrangements for workers appear to be relatively rare, although there are little data available. According to Labor data, only about eight percent of workers in small firms have SIMPLE IRAs. Only about 2 percent of them have SEP IRAs. Data are not available at all for payroll deduction IRAs.

In interviews we conducted, experts pointed to a range of possible barriers, including: administrative cost, especially for small employers who don't have automated payroll systems; a lack of incentive for employers; a perceived lack of flexibility in promoting such plans to employees; and simply a lack of awareness of these arrangements.

This leads me to my third point: how government can help. Clearly, Federal agencies have much to do to better publicize these options, and support the very small employers who need help to administer payroll deduction arrangements. They also need better aggregate data on use of such options, and what employers need.

We have made recommendations to Labor and IRS to develop more regular and informative data collection that we believe will lead to better targeting of these programs to assure higher employer participation. If the government is successful in encouraging a higher employer take-up of these options—which we believe will result in higher retirement saving—it will be important to develop an oversight strategy that balances the inducement of limited regulation against the need to assure that contributions are going to the IRAs set up to receive them.

This is why we have recommended that Congress consider assigning authority over payroll deduction IRAs, where currently there is no clear regulatory jurisdiction. This will be especially important if other policy changes are adopted, such as the auto-IRA proposals that are under consideration.

In conclusion, the IRA is an excellent and well-used means to preserve retirement assets that have already been saved. But it is under-utilized as a means to build saving. It's particularly disappointing that payroll deduction IRAs, which require so little of employers, are so seldom offered. Government can and should do more to encourage and oversee these savings arrangements to help all Americans better prepare for their retirement future.

That concludes my statement. I hope I can submit my written statement for the record, and I await your questions.

[The prepared statement of Ms. Bovbjerg follows:]

GAO

United States Government Accountability Office

Testimony
Before the Subcommittee on Select
Revenue Measures,
Committee on Ways and Means,
House of Representatives

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INDIVIDUAL RETIREMENT ACCOUNTS

Government Actions Could Encourage More Employers to Offer IRAs to Employees

Statement of Barbara D. Bovbjerg, Director
Education, Workforce, and Income Security



GAO-08-830T



Why GAO Did This Study

Congress created individual retirement accounts (IRAs) with two goals: (1) to provide a retirement savings vehicle for workers without employer-sponsored retirement plans, and (2) to preserve individuals' savings in employer-sponsored retirement plans when they change jobs or retire. Questions remain about IRAs' effectiveness as a vehicle to facilitate new, or additional, retirement savings. GAO was asked to report on (1) the role of IRAs in retirement savings, (2) the prevalence of employer-sponsored and payroll-deduction IRAs and barriers discouraging employers from offering these IRAs, and (3) changes that are needed to improve IRA information and oversight. GAO reviewed published reports from government and financial industry sources and interviewed retirement and savings experts, small business representatives, IRA providers, and federal agency officials.

What GAO Recommends

GAO is not making recommendations at this time.

To view the full product, including the scope and methodology, click on GAO-05-0907. For more information, contact Barbara Bonberg at (202) 542-7215 or bonbergb@gao.gov.

June 2005

INDIVIDUAL RETIREMENT ACCOUNTS

Government Actions Could Encourage More Employers to Offer IRAs to Employees

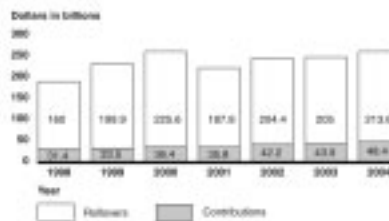
What GAO Found

Although Congress created IRAs to allow individuals to build and preserve their retirement savings, IRAs are primarily used to preserve savings through rollovers rather than build savings through contributions. Over 90 percent of assets that flow into IRAs come from assets rolled over, or transferred, from other accounts and not from direct contributions. Assets in IRAs now exceed assets in the most common employer-sponsored retirement plans: defined contribution plans, including 401(k) plans, and defined benefit, or pension plans.

Payroll-deduction IRA programs, which allow employees to contribute to IRAs through deductions from their paychecks, and employer-sponsored IRAs, in which an employer establishes and contributes to IRAs for employees, were established to provide more options for retirement savings in the workplace. Experts GAO interviewed said that several factors may discourage employers from offering these IRAs to employees, including administrative costs and concerns about employer fiduciary responsibilities. Information is lacking on how many employers offer employer-sponsored and payroll-deduction IRAs and the actual costs to employers for administering payroll-deduction IRAs.

Earlier this month, GAO reported on the role that federal agencies can have in helping employers provide IRAs to employees and in improving oversight of these savings vehicles. GAO made several recommendations to the Department of Labor (Labor) and the Internal Revenue Service to provide better information and oversight, but in the course of the review, GAO found that Labor does not have jurisdiction over payroll-deduction IRAs. Consequently, GAO also suggested that Congress may wish to consider whether payroll-deduction IRAs should have some direct oversight. A clear oversight structure could be critical if payroll-deduction IRAs become a more important means to provide a retirement savings vehicle for workers who lack an employer-sponsored retirement plan.

IRA Contributions and Rollovers, 1998 to 2004



Source: Investment Company Institute

United States Government Accountability Office

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today as you examine issues related to individual retirement accounts (IRAs) and their role in facilitating retirement savings for individuals. Congress created IRAs more than 30 years ago through the Employee Retirement Income Security Act of 1974 (ERISA) with two distinct purposes: (1) to provide individuals who are not covered by an employer-sponsored retirement plan with a tax-preferred account in which to save for retirement, and (2) to provide individuals who are covered by a plan a means to preserve their savings by allowing them to rollover, or transfer, plan balances into IRAs. Since that time, IRA assets have grown to an estimated \$3.5 trillion in 2004.

Over the years, Congress has created different types of IRAs to encourage saving for retirement. Traditional and Roth IRAs are designed to be set up and used by individuals; two other types are employer-sponsored IRAs and are designed for small employers and their employees. Under payroll-deduction IRA programs, also known as payroll-deduction IRAs, employees may contribute to traditional and Roth IRAs through their employer's payroll system. Despite the growth in IRA assets and the varied types of IRAs, questions remain about whether Congress's initial goal for IRAs has been met: to help workers without a workplace retirement plan to save for retirement on their own behalf.

My comments today are based primarily on findings from our June 2006 report entitled *Individual Retirement Accounts: Government Actions Could Encourage More Employers to Offer IRAs to Employees*.¹ My remarks focus on (1) the role of IRAs in retirement savings, (2) the prevalence of employer-sponsored and payroll-deduction IRAs and barriers discouraging employers from offering these IRAs, and (3) changes that are needed to improve IRA information and oversight.

In conducting our work, we evaluated retirement fund assets using published data from federal agencies, including the Federal Reserve's Survey of Consumer Finance, and the Internal Revenue Service's (IRS) Statistics of Income, and relevant data from financial industry associations on retirement funds. We also analyzed demographic data from household surveys, including the U.S. Bureau of the Census Current Population

¹GAO, *Individual Retirement Accounts: Government Actions Could Encourage More Employers to Offer IRAs to Employees*, GAO-06-508 (Washington, D.C.: June 4, 2006).

Reports, and the Investment Company Institute's IRA Owners Survey, which focuses on IRA ownership. To determine the prevalence of employer-sponsored and payroll-deduction IRAs, we consulted available government and financial industry data on the percentage of households and workers participating in employer-sponsored IRAs. To corroborate available data, we interviewed officials at IRS and the Department of Labor (Labor) as well as representatives of small business member organizations, financial industry representatives, and other retirement and savings experts. To identify barriers that may discourage small employers from establishing employer-sponsored IRAs and from offering payroll-deduction IRAs to employees, we interviewed federal agency officials, industry associations, financial company representatives, small business and consumer advocacy groups, and retirement and savings experts. To evaluate federal oversight of IRAs, we reviewed laws governing agency responsibilities regarding IRAs and interviewed officials at IRS and Labor.⁴ We conducted this performance audit from September 2007 to June 2008 in accordance with generally accepted government auditing standards, which included an assessment of data reliability. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

In summary, we found that although Congress created IRAs for individuals to both build and preserve retirement savings, IRAs are primarily used to preserve savings through rollovers rather than to build savings through contributions. In fact, the majority of assets that flow into IRAs come from other accounts and not from new contributions. We also found that employee access to payroll-deduction and employer-sponsored IRAs is limited. Although employer-sponsored and payroll-deduction IRA programs could help many workers to save, experts we interviewed said several factors may discourage employers from offering these IRAs, including administrative costs. Data on the actual cost to employers for managing payroll-deduction IRAs are not available. Earlier this month, we reported on the role that federal agencies can have in helping employers provide IRAs to employees and improve oversight of these savings vehicles.⁵ We made several recommendations to Labor and IRS to improve

⁴A more detailed discussion of our methodology is provided in app. I to GAO-08-580.

⁵GAO-08-580.

IRA information and oversight, but during the course of our work, we found that Labor provides guidance, but does not have jurisdiction over payroll-deduction IRAs. Consequently, we also suggested that Congress may wish to consider whether payroll-deduction IRAs should have some direct oversight. A clear oversight structure could be critical if payroll-deduction IRAs become a more important means to provide a retirement savings vehicle for workers who otherwise lack an employer-sponsored retirement plan.

Background

Since the early 1980s, roughly half of the private-sector work force has participated in either a defined benefit (DB) retirement plan, commonly known as a pension, or a defined contribution (DC) plan, such as a 401(k) plan.⁴ In 2006, approximately 79 million—or about half of all workers—worked for an employer or union sponsoring either a DB or DC plan, and about 62 million workers participated in such a plan.⁵ Congress created IRAs, in part, to help those individuals not covered by a DB or DC plan save for retirement. Employees of small firms, for example, are unlikely to work for an employer that sponsors either a DB or DC retirement plan. Almost half of all U.S. private sector workers in 2006 were employed by firms with fewer than 100 employees, and only 1 in 4 of these workers worked for an employer sponsoring a retirement plan.⁶ Currently there are

⁴Private sector pension plans are classified either as DB or DC plans. DB plans promise to provide, generally, a fixed level of monthly retirement income that is based on salary, years of service, and age at retirement, regardless of how the plan investments perform. In contrast, benefits from DC plans are based on the contributions to and the performance of the investments in individual accounts, which may fluctuate in value. Examples of DC plans include 401(k) plans, employee stock ownership plans, and profit-sharing plans. The most dominant and fastest growing DC plans are 401(k) plans, which allow workers to choose to contribute a portion of their pre-tax compensation to the plan under section 401(k) of the Internal Revenue Code.

⁵Craig Copeland, "Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2006," *Issue Brief*, no. 311, (Washington D.C., Employee Benefit Research Institute, November 2007).

⁶The Employee Benefit Research Institute, a private, nonprofit public policy research organization, estimated that in 2006, over 66 million workers were employed by private sector employers with fewer than 100 employees. Of these workers, 16.7 million had access to an employer-sponsored retirement plan. See Craig Copeland, "Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2006," additional data from the U.S. Bureau of the Census, March 2007 Current Population Survey provided by the author.

Individual IRAs	<p>several types of IRAs for individuals and small employers and their employees.¹</p> <p>Traditional and Roth IRAs are geared toward individuals and offer different tax preferences to encourage savings.</p> <ul style="list-style-type: none"> • Traditional IRAs. Traditional IRAs allow individuals to defer taxes on investment earnings accumulated in these accounts until distribution at retirement. Eligible individuals may make tax-deductible contributions, and others may make nondeductible contributions.² • Roth IRAs. Through Roth IRAs, eligible individuals may make after-tax contributions, and after age 59½, enrollees may take tax-free distributions of their investment earnings.³ <p>Both traditional and Roth IRAs can also be established through payroll-deduction IRA programs (also called payroll-deduction IRAs) which require employer involvement.</p> <ul style="list-style-type: none"> • Payroll-deduction IRA Programs. Employees may establish and contribute to either traditional or Roth IRAs through voluntary deductions from their pay forwarded by their employer to employee IRAs. As long as employers follow guidelines set by Labor for managing payroll-deduction IRAs, employers are not subject to the fiduciary requirements in ERISA Title I that apply to employer-sponsored retirement plans.⁴
	<p>¹This is a simplified discussion of the features and rules associated with traditional, Roth, and SIMPLE and SEP IRAs and payroll-deduction IRA programs. For a more detailed discussion, see GAO-05-580.</p> <p>²Other rules for traditional IRAs also apply. For example, yearly contribution amounts are subject to limits based on earned income, pension coverage, and filing status. Taxpayers over age 70½ cannot contribute and must begin required minimum distributions from these accounts. Withdrawals are generally taxable and early distributions made before age 59½ other than for specific exceptions are subject to a 10 percent additional income tax. Withdrawals for the purchase of a first-time residence or payments for higher education are not subject to additional tax, as provided under specific tax rules.</p> <p>³Other rules apply to Roth IRAs. For example, yearly contribution amounts are subject to limits based on earned income and filing status. Withdrawals of investment earnings before age 59½ are subject to a 10 percent additional tax and other taxes. Yearly contribution amounts are subject to limits based on income and filing status. There are no age limits on contributing, and no distributions are required during the owner's lifetime. Withdrawals are generally tax free after age 59½ as long as the taxpayer held the account for 5 years.</p> <p>⁴See 29 C.F.R. § 2509.30-1 (also known as Interpretive Bulletin 30-1).</p>

Employer-Sponsored IRAs	<p>Congress created two types of employer-sponsored IRAs with fewer regulatory requirements than DB and DC plans to encourage small employers to offer IRAs to their employees:</p> <ul style="list-style-type: none"> • Savings Incentive Match Plans for Employees (SIMPLE). SIMPLE IRAs, available only to employers with 100 or fewer employees, allow eligible employees to direct a portion of their salary, within limits, to a SIMPLE IRA.¹³ Employers sponsoring SIMPLE IRAs must either match the employee's contributions up to 3 percent of his or her compensation or make 2 percent contributions of each employee's salary to the SIMPLE IRAs for all employees making at least \$5,000 for the year. • Simplified Employee Pensions (SEP). SEP IRAs allow employers to make tax-deductible contributions to their own and each eligible employee's traditional IRA at higher contribution limits than other IRAs.¹⁴ SEP IRAs do not permit employee contributions, and annual employer contributions are not mandatory.¹⁵ <p>IRS and Labor share oversight responsibilities for IRAs. Labor's Employee Benefits Security Administration (EBSA) enforces ERISA Title I, which specifies the standards for employer-sponsored retirement plans, including applicable fiduciary reporting and disclosure requirements. EBSA also oversees the fiduciary standards for employer-sponsored IRAs, and seeks to ensure that fiduciaries, such as employers, operate their plans in the best interest of plan participants. While Labor does not have direct oversight of payroll-deduction IRA programs, it has provided "safe</p>
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¹³Congress created SIMPLE IRAs in the Small Business Job Protection Act of 1996. SIMPLE IRAs replaced the Salary Reduction Simplified Employee Pension IRA (SAR-SEP IRA)—a tax-deferred retirement plan provided by sole proprietors or small businesses with fewer than 25 employees. SAR-SEP IRAs could not be established after December 31, 1996, but plans in operation at that time were allowed to continue. For those plans still in operation in 2008, SAR-SEP IRAs allow eligible employees to contribute up to \$15,500 per year, and employers may contribute 25 percent of an employee's compensation, up to a maximum \$40,000.

¹⁴Congress established SEP IRAs in the Revenue Act of 1978. As with DB plans, SEP IRA contributions must be based on a written allocation formula and cannot discriminate in favor of highly compensated employees.

¹⁵In addition to SEP and SIMPLE IRAs, employers may offer "deemed IRAs" to their employees, which allow employees to keep IRA assets in their employer's tax-qualified retirement plan as a separate traditional or Roth IRA. Employees may make voluntary contributions to the deemed IRA, subject to IRA rules. According to the Department of the Treasury, few such IRAs exist.

harbor” guidance to employers, which sets the conditions by which employers may offer payroll-deduction IRA programs without becoming subject to ERISA Title I requirements.¹³ IRS enforces Title II of ERISA for all types of IRAs, which provides tax benefits for retirement plan sponsors and participants and details participant eligibility, vesting, and funding requirements. IRS also enforces various tax rules for IRAs, including rules for eligibility, contributions, distributions, and rolling assets into IRAs or converting assets from a traditional IRA into a Roth IRA. (See table 1 for annual contribution limits for IRAs.)

Table 1: Contribution Limits for IRAs, 2008

	Individual IRAs		Employer-Sponsored IRAs	
	Traditional IRA ¹	Roth IRA ²	SIMPLE IRA	SEP IRA
Individual/employee contribution limit ³	Up to \$5,000, or \$6,000 for eligible participants over age 50	Up to \$5,000, or \$6,000 for eligible participants over age 50	Up to \$10,500, or \$13,500 for eligible participants over age 50	Employees cannot contribute
Employer contribution limit	Not applicable	Not applicable	Contribution equal to 2 percent of employee's compensation or matching contributions up to 3 percent of employee's compensation ⁴	25 percent of an employee's compensation, up to maximum of \$46,000

Source: Internal Revenue Service.

¹Employees may choose to contribute to either traditional or Roth IRAs through an employer's payroll-deduction IRA program, and employee contributions are subject to either traditional or Roth IRA rules. Employers may not contribute to employee IRAs through payroll-deduction IRA programs.

²Only employees of firms offering SIMPLE or SEP IRAs may contribute to these IRAs, while any eligible individual may contribute to traditional or Roth IRAs. The annual total IRA contribution limit applies across Roth and traditional IRAs and is not an annual limit for each IRA type.

³Employers may reduce the 3 percent contribution limit to a lower percentage but not lower than 1 percent. Employers may not contribute less than 3 percent for more than 2 calendar years in a 5-year period.

¹³See Interpretive Bulletin 89-1. Labor's guidance explains that an employer who establishes a payroll-deduction IRA program is not considered to have established an employee retirement plan subject to ERISA if the following are satisfied: (1) the employer maintains neutrality with respect to IRA investment options available in communications with employees; (2) the employer establishes limitations on the number of IRA investment options available, the program discloses any costs or limitations on employees' ability to rollover to other IRAs; (3) the employer does not pay any administrative, investment management, or other fees which the IRA sponsor would require an employee to pay for establishing or maintaining the IRA; (4) the employer does not receive any consideration beyond "reasonable compensation" for operating the program.

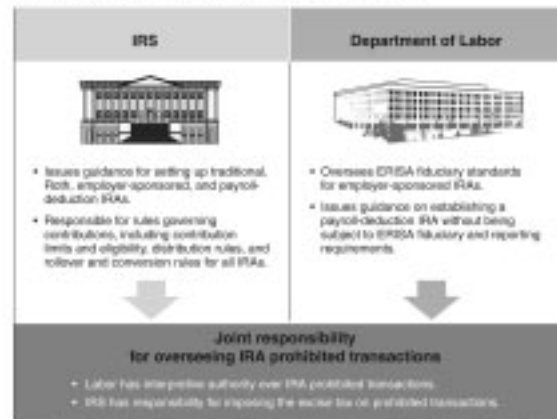
Labor and IRS work together to oversee IRA prohibited transactions. In general, prohibited transactions include any improper use of an IRA by the account holder or others.¹³ Labor generally has interpretive jurisdiction over prohibited transactions and IRS has certain enforcement authority. Both ERISA and the Internal Revenue Code contain various statutory exemptions from the prohibited transaction rules, and Labor has authority to grant administrative exemptions and establish exemption procedures.¹⁴ Labor may grant administrative exemptions on a class or individual basis for a wide variety of proposed transactions in a plan. IRS has responsibility for imposing an excise tax on parties that engage in a prohibited transaction.¹⁵ (See fig. 1 for a description of IRS and Labor responsibilities regarding IRAs.)

¹³Individuals subject to prohibited transaction rules include the individual who established the IRA, members of the individual's family, and fiduciaries. Examples of prohibited transactions with an IRA include: borrowing money from an IRA, selling property to it, receiving unreasonable compensation for managing the account, using the account as security for a loan, and buying property for personal use with IRA funds. The Department of the Treasury retains authority only with respect to transactions that are exempted by subsection 404(c) of ERISA from the application of the prohibited transaction provisions of Title I of ERISA.

¹⁴The statutory exemptions generally include loans to participants, the provision of services needed to operate a plan for reasonable compensation, loans to employee stock ownership plans, and investment with certain financial institutions regulated by other state or federal agencies. Reorganization Plan No. 4 of 1978 transferred the Department of the Treasury's authority over prohibited transaction exemptions to Labor, with certain exceptions.

¹⁵A provision of the Internal Revenue Code directly imposes an excise tax against disqualified persons, including employee benefit plan sponsors and service providers, who engage in prohibited transactions with tax-qualified pension and profit-sharing plans. The IRS must coordinate with Labor regarding the imposition of the excise tax under section 4975 of the Internal Revenue Code. In place of the imposition of an excise tax under the Internal Revenue Code, if the prohibited transaction involves the IRA owner, the IRA is disqualified from favorable tax treatment.

Figure 1: Primary Responsibilities of IRS and Labor for IRAs



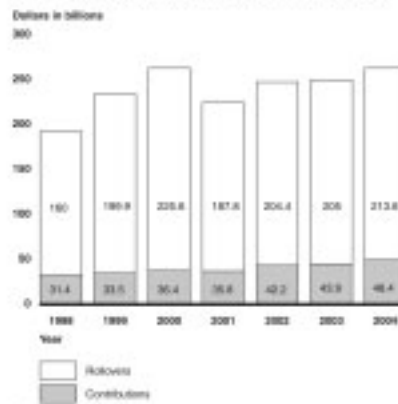
Source: GAO analysis of Employee Retirement Income Security Act of 1974 and the Internal Revenue Code. Art Epsilon Images.

IRAs Are Primarily Used to Preserve Savings through Rollovers

Most assets flowing into IRAs come not from direct contributions, but from transfers, or rollovers, of retirement assets from other retirement plans, including 401(k) plans. These rollovers allow individuals to preserve their retirement savings when they change jobs or retire. As shown in figure 2, from 1998 to 2004, more than 80 percent of funds flowing into IRAs came from rollovers, demonstrating that IRAs play a significantly smaller role in building retirement savings than in preserving them. In addition, IRA accounts with rollover assets were larger than those without rollover assets. For example the median amount in a traditional IRA with rollover assets in 2007 was \$61,000, while the median amount in a traditional IRA without rollover assets was \$30,000.²⁹

²⁹See Holden and Michael Douglas, "The Role of IRAs in U.S. Households' Saving for Retirement," *Research Perspectives*, vol. 17, no. 1 (Washington D.C., Investment Company Institute, January 2009).

Figure 2: IRA Contributions and Rollovers, 1998 to 2004



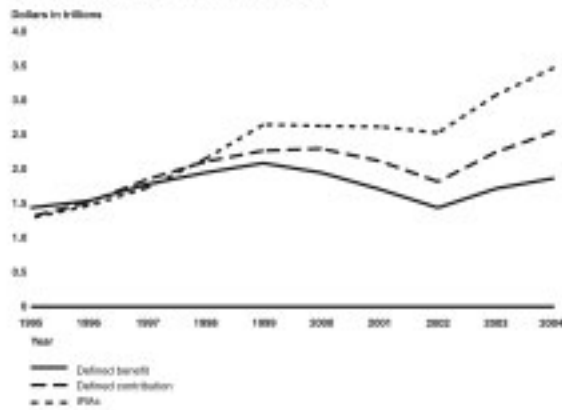
Source: Investment Company Institute

Note: IRA contributions include those made to traditional IRAs, Roth IRAs, and employer-sponsored IRAs. Figures for 2003 and 2004 include estimates and projections.

Since 1998, IRA assets have comprised the largest portion of the retirement market. As shown in figure 3, IRA assets in 2004 totaled about \$3.5 trillion compared to DC assets of \$2.6 trillion and DB assets of \$1.9 trillion.¹⁷

¹⁷Craig Copeland, "Individual Account Retirement Plans: An Analysis of the 2004 Survey of Consumer Finances," *Issue Brief*, no. 293 (Washington D.C., Employee Benefit Research Institute, May 2006).

Figure 3: Retirement Plan Assets, 1995 to 2004



Source: Employee Benefit Research Institute.

More households own traditional IRAs, which were the first IRAs established, than Roth IRAs or employer-sponsored IRAs. In 2007, nearly 35 percent of all households owned traditional IRAs, and about 15 percent owned Roth IRAs. In contrast, about 8 percent of households participated in employer-sponsored IRAs.⁴⁵

Ownership of traditional and Roth IRAs is associated with higher education and income levels. In 2004, 59 percent of IRA households were headed by an individual with a college degree, and only about 3 percent were headed by an individual with no high school diploma.⁴⁶ Over one-

⁴⁵Sam Holden and Michael Beglau, "Appendix: Additional Data on IRA Ownership in 2007," *Research Findings*, vol. 17, no. 1A (Washington D.C., Investment Company Institute, January 2008).

⁴⁶Additional analysis of the Federal Reserve's Survey of Consumer Finances by the Employee Benefit Research Institute. Craig Copeland, "Individual Account Retirement Plans: An Analysis of the 2004 Survey of Consumer Finances," *Issue Brief*, no. 280 (Washington D.C., Employee Benefit Research Institute, May 2006).

third of these IRA households earned \$100,000 or more; about 2 percent earned less than \$10,000. Households with IRAs also tend to own their homes. Research shows that higher levels of education and household income correlate with a greater propensity to save.²⁷ Therefore, it is not surprising that IRA ownership increases as education and income levels increase. However, despite the association of IRA ownership to individuals with higher incomes, data show that lower- and middle-income individuals also own IRAs. A study by the Congressional Budget Office (CBO) found that in 2003, 4 percent of workers earning \$20,000 to \$40,000 (in 1997 dollars) contributed to traditional IRAs and 3 percent of these workers contributed to Roth IRAs. In the same year, 7 percent of workers earning between \$120,000 and \$160,000 contributed to a traditional IRA and 8 percent contributed to a Roth IRA.²⁸ The study also found that 33 percent of individuals earning \$20,000 to \$40,000 who contributed to a traditional IRA contributed the maximum amount allowed, and 35 percent made maximum contributions to their Roth IRAs.²⁹ By contrast, 87 percent of individuals earning \$120,000 to \$160,000 who contributed to a traditional IRA made the maximum contribution, and 61 percent made the maximum contribution to their Roth IRAs.

A study by the Investment Company Institute (ICI) that included data on contributions by IRA owners shows that more households with Roth IRAs or employer-sponsored IRAs contribute to their accounts than households with traditional IRAs.³⁰ For example more than half of households with Roth, SIMPLE, or Salary Reduction Simplified Employee Pension IRA (SAR-SEP IRA) contributed to their accounts in 2004, but less than one-

²⁷Sara Haidles, Kathy Ireland, Victoria Leonard-Chambers, and Michael Bogdan, "The Individual Retirement Account at Age 30: A Retrospective," *Perspective*, vol. 13, no. 1 (Washington D.C., Investment Company Institute, February 2005).

²⁸Congressional Budget Office, *Utilization of Tax Incentives for Retirement Savings: Update to 2002* (Washington, D.C., March 2007). The eligibility rules for Roth IRAs and for tax-deductible contributions to traditional IRAs may influence IRA participation rates. For example, an individual's eligibility to contribute to Roth IRAs is based on their modified adjusted gross income (AGI) and their tax filing status. Eligibility for a full or partial deduction for traditional IRA contributions depends on whether a taxpayer or spouse is covered by an employer-sponsored retirement plan, as well as limits on modified AGI and filing status.

²⁹The income categories in the CBO study are reported in 1997 dollars. Some workers may have both a traditional and Roth IRA.

³⁰Sandra West and Victoria Leonard-Chambers, "The Role of IRAs in Americans' Retirement Preparedness," *Research Perspectives*, vol. 15, no. 1 (Washington D.C., Investment Company Institute, January 2005).

third of households with traditional IRAs did so. This, again, may be partly attributed to the emerging role of traditional IRAs as a means to preserve rollover assets rather than build retirement savings. The ICI study also stated that the median household contribution to traditional IRAs was \$2,300 compared to the median contribution to Roth IRAs of \$3,000. The median contribution to SIMPLE and SAR-SEP IRAs was \$5,000. The study noted that this difference may be related to higher contribution limits for employer-sponsored IRAs than for traditional and Roth IRAs.

Worker Access to Employer-Sponsored and Payroll-Deduction IRAs Appears Limited, and Several Barriers May Discourage Employers from Offering These IRAs

According to experts and available government data, worker access to employer-sponsored and payroll-deduction IRAs appears limited. To address the issue of low retirement plan sponsorship among small employers, Congress created SEP and SIMPLE employer-sponsored IRAs. Labor issued a regulation under which an employer could maintain a payroll-deduction program for employees to contribute to traditional and Roth IRAs without being considered a pension plan under ERSISA. Although employer-sponsored IRAs have few reporting requirements to encourage small employers to offer them, and payroll-deduction IRAs have none, worker access to these IRAs appears limited. Increased access to payroll-deduction IRAs could help many workers to save for retirement, but several barriers, including costs to employers, may discourage employers from offering these IRAs to their employees. Retirement and savings experts offer several proposals to encourage employers to offer and employees to participate in payroll-deduction IRAs.

Worker Access to Employer-Sponsored and Payroll-Deduction IRAs Appears Limited

The majority of employers with fewer than 100 employees do not offer an employer-sponsored retirement plan for their employees. In 2006, almost half of all U.S. private sector workers were employed by firms with fewer than 100 employees, and only 1 in 4 of these employees worked for an employer sponsoring a retirement plan.²⁶ To address the issue of low retirement plan sponsorship among small employers, Congress created SIMPLE and SEP employer-sponsored IRAs with less burdensome reporting requirements than 401(k) plans to encourage their adoption by small employers. In addition, under a regulation issued by Labor, employers may also provide payroll-deduction IRA programs, which allow

²⁶See Craig Copeland, "Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2006," with additional data from the 2007 March Current Population Survey provided by the author.

employees to contribute to traditional or Roth IRAs through payroll-deductions by their employer, without employers being considered a pension plan sponsor under ERISA and becoming subject to various ERISA fiduciary and reporting requirements.⁷⁷ In order to encourage their adoption, employer-sponsored and payroll-deduction IRAs offer a variety of features designed to appeal to small employers (see table 2).

Table 2: Features of Employer-Sponsored and Payroll-Deduction IRAs

IRA features	Employer-sponsored IRAs		Payroll-deduction IRAs
	SIMPLE IRAs ^a	SEP IRAs ^b	
Employee contributions allowed	✓		✓
Employer contributions allowed	✓	✓	
Mandatory annual employer contributions	✓		
No employer financial reporting requirements	✓	✓	✓
Employer tax credit available for partial start-up costs	✓	✓	
Available to all employers		✓	✓
Available to all employer's workers			✓

Source: SAG analysis of Labor and RES Publications 3096.

^aSIMPLE IRAs are limited to employers with fewer than 100 employees. Employers sponsoring SIMPLE IRAs must offer the IRAs to all employees who have earned income of at least \$5,000 in any prior 2 years and are reasonably expected to earn at least \$5,000 in the current year.

^bEmployers sponsoring SEP IRAs must offer the IRAs to all employees who are at least 21 years of age, employed by the employer for 3 of the last 5 years, and had compensation of \$500 for 2007.

Data on the number of employers offering employees employer-sponsored IRAs and payroll-deduction IRAs is limited. However, based on available data, employee access to SIMPLE and SEP IRAs appears limited. Under ERISA Title I, there is no reporting requirement for SIMPLE IRAs, and there is an alternative method available for reporting of employer-

⁷⁷See 29 C.F.R. § 2510.3-2(d).

sponsored SEP IRAs.²⁸ Payroll-deduction IRA programs are not subject to ERISA requirements for employer-sponsored retirement plans and have no reporting requirements. Because there are very limited reporting requirements for employer-sponsored IRAs and none for payroll-deduction IRAs, information on employers who offer these IRAs is limited and we were unable to determine how many employers actually do so. For example, the Bureau of Labor Statistics provides some data on the percentage of employees participating in employer-sponsored IRAs, but no data on the percentage of employers sponsoring them. The Bureau of Labor Statistics reported that 8 percent of private sector workers in firms with fewer than 100 employees participated in a SIMPLE IRA in 2005, and 2 percent of these workers participated in a SEP IRA.²⁹ An IRS evaluation of employer-filed W-2 forms estimated that 190,000 employers sponsored SIMPLE IRAs in 2004.³⁰ IRS did not provide an estimate of the number of employers sponsoring SEP IRAs, and we were unable to determine how many employers make these IRAs available to employees.

Few employers appear to offer their employees the opportunity to contribute to IRAs through payroll deductions, but data are insufficient to make this determination. Through payroll-deduction IRA programs, employees may contribute to traditional or Roth IRAs by having their employer withhold an amount determined by the employee and forwarded directly to the employee's IRA. Although any employee can provide payroll-deduction IRAs to their employees, regardless of whether or not they offer another retirement plan, retirement and savings experts told us that very few employers do so. Because employees are not required to

²⁸Section 105(h)(1) of ERISA Title I provides that no report shall be required for qualified salary reduction arrangements under section 408(a) of the Internal Revenue Code (SIMPLE IRAs). In addition, Labor provides an alternative method of compliance for reporting SEP arrangements through IRS Form 5300-SEP.

²⁹U.S. Department of Labor, U.S. Bureau of Labor Statistics, *National Compensation Survey: Employee Benefits in Private Industry in the United States, 2005*, Bulletin 2580 (May 2007). SIMPLE IRAs are only available to firms with 100 employees or fewer who do not already offer another retirement plan; SEP IRAs are available to employers of any size, including those who may offer either a DC or DB plan.

³⁰However, officials told us that this figure was likely understated, as it does not include accounts that may be owned by sole proprietors or individuals who own unincorporated businesses by themselves, who are not required to file W-2 forms.

report this activity to the federal government, neither Labor nor IRS is able to determine how many employers offer payroll-deduction IRAs.²¹

Employer-Sponsored and Payroll-Deduction IRAs Could Help Workers to Save, but Several Barriers May Discourage Employers from Offering These IRAs

According to experts and economics literature that we reviewed, individuals are more likely to save for retirement through payroll deductions than they are without payroll deductions. Both SIMPLE IRAs and payroll-deduction IRA programs allow workers to contribute to their retirement through payroll deductions.²² Payroll deductions are a key feature in 401(k) and other DC plans. Economics literature that we reviewed identifies payroll deduction as a key factor in the success of 401(k) plans, and participation in these plans is much higher than in IRAs, which do not typically use payroll deduction. The Congressional Budget Office reported that 29 percent of all workers contributed to a DC plan in 2003—where payroll deductions are the norm—while only 7 percent of all workers contributed to an IRA.²³

Saving for retirement in the workplace through payroll deductions helps workers save by providing a “commitment device” to make automatic contributions to retirement savings before wages are spent.²⁴ Such a commitment device helps some workers overcome a common tendency to procrastinate or not take action to save based on the choices associated

²¹Labor and IRS officials told us data are limited on how many employers offer payroll-deduction IRAs; however, Labor and IRS have taken steps to promote these plans. For example, in 2005, Labor issued a regulation describing the conditions under which payroll-deduction IRA programs offered by employers are not considered a pension plan under Title I of ERISA. See 20 C.F.R. § 2518.3-2(a). In 2009, Labor issued Interpretive Bulletin 09-1, which set the conditions under which employers could offer payroll-deduction IRAs and remain clear of the reporting and disclosure requirements, fiduciary duties, and enforcement rights under ERISA Title I that apply to employer-sponsored pensions. See 20 C.F.R. § 2508.80-1, and 64 Fed. Reg. 33009 (June 18, 1999). In 1999, IRS issued an announcement providing information to employees and employers on payroll-deduction contributions for Roth and traditional IRAs. See Internal Revenue Bulletin 1999-2, at 44 (Jan. 11, 1999).

²²SEP IRAs do not offer this feature. Only employers may contribute to SEP IRAs and employee contributions to these IRAs are not permitted.

²³Congressional Budget Office, “Utilization of Tax Incentives for Retirement Saving: Update to 2003,” Background Paper (Washington, D.C., March 2007).

²⁴Steven F. Venti, “Choice, Behavior, and Retirement Saving,” in *The Oxford Handbook of Pensions and Retirement Income*, Eds. Gordon C. Clark, Alicia H. Munnell, and J. Michael Orszag (Oxford, Great Britain, 2006) 403-17; and Olivia Mitchell and Stephen Utkin, “Lessons from Behavioral Finance for Retirement Plan Design,” *Pension Research Council Working Paper*, PRC WP 2003-6 (Philadelphia, Pa., 2003).

with investing or selecting a retirement savings vehicle. Payroll deductions allow workers to contribute to retirement savings automatically before wages are spent, relieving them of making ongoing decisions to save. According to Labor's guidance on payroll-deduction IRAs and several experts we interviewed, individuals are more likely to save in IRAs through payroll deductions than they are without these automatic deposits.

Payroll-deduction IRA programs could provide a retirement savings opportunity at work for the millions of workers without an employer-sponsored retirement plan. In theory, all workers under age 70½ who lack an employer-sponsored retirement plan could be eligible to contribute to a traditional IRA through payroll deduction, should their employer offer such a program.³³ Further, based on the contribution rules for traditional and Roth IRAs, many of these individuals would be eligible to claim a tax deduction for their traditional IRA contributions,³⁴ and most low- and middle-income workers would be eligible to contribute to Roth IRAs.³⁵ Experts told us payroll-deduction IRAs are the easiest way for small employers to offer their employees a retirement savings vehicle. Payroll-deduction IRAs have fewer requirements for employee communication

³³Individuals who have already established an IRA on their own and who currently contribute at the maximum would not be eligible to contribute to payroll-deduction IRAs. Others who already have an IRA but contribute less than the maximum could contribute additional amounts in a payroll-deduction IRA, but could not go over the overall limit.

³⁴Any individual under the age of 70½ with taxable compensation may contribute to a traditional IRA, and many individuals could receive a tax deduction for their contribution. Eligibility for a full or partial deduction for traditional IRA contributions depends on whether a taxpayer or spouse is covered by an employer plan, as well as limits on modified adjusted gross income (AGI) and filing status. For example, a single worker not covered by an employer plan is eligible for the full deduction regardless of income, and a married taxpayer filing jointly whose spouse is covered by an employer plan can take the full deduction if the couple's modified AGI is \$183,000 or less for 2008. Other individuals may be eligible for partial deductions, and even those ineligible for any deduction can still make nondeductible contributions to a traditional IRA.

³⁵An individual's eligibility to contribute to Roth IRAs is based on their modified AGI and their tax filing status. For example, in 2008, single, head-of-household and married individuals filing separately with a modified AGI of less than \$93,000 could contribute up to \$5,000 (\$6,000 if age 50 or older). Individuals with an AGI that is more than \$93,000 but less than \$116,000 could contribute at reduced limits. Individuals making \$116,000 or more could not contribute to Roth IRAs. Individuals that are married, filing jointly, or qualified widowers, with a modified AGI less than \$183,000 could contribute up to the \$5,000 limit (\$6,000 if age 50 or older). Couples with income between \$150,000 and \$183,000 could contribute at reduced limits. Those making more than \$183,000 cannot contribute.

than SIMPLE and SEP IRAs,³⁷ and employers are not subject to ERISA fiduciary responsibilities as long as they meet the conditions in Labor's regulation and guidance for managing these plans.³⁸

Employer-sponsored IRAs may also help employees of small firms save for their retirement. For example, the higher contribution limits for SIMPLE and SEP IRAs offer greater savings benefits than payroll-deduction IRAs.³⁹ In 2007, individuals under age 50 were able to contribute up to \$10,500 to SIMPLE IRAs—more than twice the amount allowed in 2007 for payroll-deduction IRAs.⁴⁰ Since SIMPLE IRAs require employers to either match the contributions of participating employees or make nonelective contributions to all employee accounts, employees are able to save significantly more per year in SIMPLE IRAs than they are in payroll-deduction IRAs.

As we previously reported, we found that several factors may discourage employers from establishing employer-sponsored SIMPLE and SEP IRAs. For example, small business groups told us that the costs of managing SIMPLE and SEP IRAs may be prohibitive for small employers. Experts also pointed out that certain contribution requirements for these plans may, in some cases, limit employer sponsorship of these plans. For example, because SIMPLE IRAs require employers to make contributions to employee accounts, some small firms may be unable to commit to these

³⁷For example, SIMPLE IRAs require employers to provide employees with a summary plan description and an annual election notice. SEP IRAs require employers to provide employees with written statements that explain the terms of the pension, how changes are made, and when employees will receive information about contributions to their accounts.

³⁸Further, employers are not required to determine an employee's eligibility status for both contributions or tax-deferred contributions to traditional IRAs, which vary based on the employee's modified adjusted gross income or tax filing status. These responsibilities fall on the employee.

³⁹SIMPLE IRAs require that employers contribute to their employee's IRAs by making "nonelective" 3 percent contributions to the accounts of all employees or by matching the salary-reduction contributions of participating employees up to 3 percent of the employee's compensation with a limit of \$10,500 in 2007. Individuals over age 50 at the end of the 2007 calendar year could make an additional "catch-up" contribution of up to \$2,000 to their SIMPLE IRAs. Under a SEP, employers contribute directly to SEP IRAs for all employees, including the employer, with contributions up to 25 percent of each employee's pay, but no more than \$45,000 in 2007.

⁴⁰In 2008, SEP IRAs allowed employers to contribute the lesser of 25 percent of an employee's compensation or up to \$46,000. Compensation generally does not include contributions to the SEP.

IRAs. Small business groups and IRA providers told us that small business revenues are inconsistent and may fluctuate greatly from year to year, making required contributions difficult for some firms. In addition, employers offering SIMPLE IRAs must determine before the beginning of the calendar year whether they will match employee contributions or make nonelective contributions to all employees' accounts. According to IRA providers, this requirement may discourage some small employers from offering these IRAs, and if employers had the flexibility to make additional contributions to employee accounts at the end of the year, employers may be encouraged to contribute more to employee accounts.

With regard to SEP IRAs, two experts said small firms may be discouraged from offering these plans because of the requirement that employers must set up a SEP IRA for all employees performing service for the company in 3 of the past 5 years and with more than \$500 in compensation for 2007. These experts stated that small firms are likely to hire either seasonal employees or interns who may earn more than \$500, and these employers may have difficulty finding an IRA provider willing to open an IRA small enough for these temporary or low-earning participants.

We also found that several barriers may discourage small employers even from offering payroll-deduction IRAs, including: (1) costs to employers for managing payroll deductions, (2) a perceived lack of flexibility to promote payroll-deduction IRAs to employees, (3) lack of incentives to employers, and (4) lack of awareness about how these IRAs work.

- **Costs to employers.** Additional administrative costs associated with setting up and managing payroll-deduction IRAs may be a barrier for small employers, particularly those without electronic payroll processing. Small business groups told us that costs are influenced by the number of employees participating in the program and whether an employer has a payroll processing system in place for automatic deductions and direct deposits to employee accounts. Several experts told us many small employers lack electronic, or automatic, payroll systems, and these employers would be subject to higher management costs for offering payroll-deduction IRAs. According to Labor, costs to employers also are significantly influenced by the number of IRA providers to which an employer must remit contributions on behalf of employees.⁴¹

⁴¹As such, Labor's guidance allows employers to select a single IRA provider for all employees. Also, under Labor's guidance, an IRA sponsor may reimburse the employer for the actual costs of operating a payroll-deduction IRA as long as such costs do not include profit to the employer.

Although experts reported that payroll-deduction IRAs represent costs to employers, we found varied opinions on the significance of those costs. Experts advocating for expanded payroll-deduction IRAs reported that most employers would incur little or no costs since they already make payroll deductions for Social Security and Medicare, as well as federal, state, and local taxes. According to these experts, payroll-deduction IRAs function like existing payroll tax withholdings, and adding another deduction would not be substantial. However, other experts and one report we reviewed indicated that employer costs may be significant, particularly for employers without electronic payrolls. The report did not estimate actual costs to employers on a per account basis.⁴⁰ In our review, we were unable to identify reliable government data on actual costs to small employers.

- **Flexibility to promote payroll-deduction IRAs.** According to IRA providers, some employees are hesitant to offer a payroll-deduction IRA program because they find Labor's guidance limits their ability to effectively publicize the program to employees for fear of being subject to ERISA requirements.⁴¹ IRA providers told us employers need greater flexibility in Labor's guidance on payroll-deduction IRAs if they are to encourage employees to save for retirement. However, Labor told us that it has received no input from IRA providers as to what that flexibility would be, and Labor officials note that Interpretive Bulletin 99-1 specifically provides for flexibility.
- **Lack of savings incentives for small employers.** Small business member organizations and IRA providers said contribution limits for payroll-deduction IRAs do not offer adequate savings incentives to justify the effort in offering these IRAs.⁴² Because the contribution limits for these IRAs are significantly lower than those that apply to SIMPLE and SEP

⁴⁰Mary M. Schmitt and Judy Nantopoulos, "Automatic IRAs: Are They Administratively Feasible, What Are the Costs to Employers and the Federal Government, and Will They Increase Retirement Savings?" *Provisionary Report Prepared for AARP, Optimal Benefit Strategies, LLC* (Mar. 8, 2007).

⁴¹Labor officials told us they issued this guidance to make it easier for employers to understand the guidelines to maintain the safe harbor that applies to payroll-deduction IRAs. This guidance explains the conditions under which employers can offer payroll-deduction IRAs and not be subject to ERISA reporting and fiduciary responsibilities, which apply to employer retirement plans like 401(k) plans.

⁴²In 2008, eligible individuals were allowed to contribute a total of \$5,000 to one or more traditional and Roth IRAs, and individuals older than age 50 could contribute \$6,000.

	<p>IRAs, employers seeking to provide a retirement plan to their employees would be more likely to choose other options. Those options also allow business owners to contribute significantly more to their own retirement account than payroll-deduction IRAs.</p> <ul style="list-style-type: none"> • Lack of awareness. Representatives from small business groups said many small employers are unaware that payroll-deduction IRAs are available or that employer contributions are not required. However, Labor has produced educational materials describing the payroll-deduction and employer-sponsored IRA options available to employers and employees.
<p>Some Proposals Encourage Employers to Offer and Employees to Participate in IRAs</p>	<p>Retirement and savings experts told us that several legislative proposals could encourage employers to offer and employees to participate in IRAs. Several bills have been introduced in Congress to expand worker access to payroll-deduction IRAs.</p> <ul style="list-style-type: none"> • Employer incentives to offer IRAs. Several retirement and savings experts said additional incentives should be in place to increase employer sponsorship of IRAs. For example, experts suggested tax credits should be made available to defray start-up costs for small employers of payroll-deduction IRAs, particularly for those without electronic or automatic payroll systems. These credits should be lower than the credits available to employers for starting SIMPLE, SEP, and 401(k) plans to avoid competition with those plans, these experts said.¹⁰ IRA providers and small business groups said increasing contribution limits for SIMPLE IRAs to levels closer to those for 401(k) plans would encourage more employers to offer these plans. Other experts said doing so could provide incentives to employers already offering 401(k) plans to switch to SIMPLE IRAs, which have fewer reporting requirements. • Employee incentives to participate in IRAs. Experts offered several proposals to encourage workers to participate in IRAs, including (1) expanding existing tax credits for moderate- and low-income workers, (2) offering automatic enrollment in payroll-deduction IRAs, and (3) increasing public awareness about the importance of saving for retirement and how to do so. Several experts said expanding the scope of the <p><small>¹⁰The currently available "Tax Credit for Small Employer Pension Plan Startup Costs" applies to eligible employers who offer SEP, SIMPLE, and qualified plans. This credit is intended to cover costs to set up, administer, and educate employees about the plan for up to a maximum of \$500 per year for each of the first 3 years of the plan. It should be noted that providing a similar tax credit for employers offering payroll-deduction IRAs would have revenue implications for the federal budget.</small></p>

Retirement Savings Contribution Credit, commonly known as the "saver's credit," could encourage IRA participation among workers who are not covered by an employer-sponsored retirement plan.⁴⁷ They said expanding the saver's credit to include more middle-income earners and making the credit refundable—available to tax filers even if they do not owe income tax—could encourage more moderate- and low-income individuals to participate in IRAs. However, an expanded and refundable tax credit would have revenue implications for the federal government. Other experts told us that automatically enrolling workers into payroll deduction and SIMPLE IRAs could increase employee participation; however, small business groups and IRA providers said that mandatory automatic enrollment could be burdensome to small employers.⁴⁸ In addition, given the lack of available income for some, several experts told us that low-income workers may opt out of automatic enrollment programs or be more inclined to make early withdrawals. Experts also said increasing public awareness of the importance of saving for retirement and educating individuals about how to do so could increase IRA participation.

⁴⁷Currently, the saver's credit provides a nonrefundable tax credit to low- and moderate-income savers of up to 50 percent of their annual IRA or 401(k) contributions up to \$2,000. In 2007, the credit was available to single and married individuals filing separate income tax returns who make no more than \$20,000 and to married couples filing jointly who make no more than \$32,000. Depending on income and filing status, taxpayers may claim a credit as high as 50 percent or as low as 10 percent of their contributions. The saver's credit was designed to provide a greater savings incentive to low- and moderate-income workers who, because of their lower marginal tax rates, receive lower tax subsidies by saving in tax-preferred accounts, such as IRAs, than higher income individuals.

⁴⁸Several studies show that 401(k) plans with automatic enrollment features have increased participation rates, especially among young and lower income workers who are less likely to participate in these plans. However, as previously mentioned, 401(k) plans are different from IRAs with different incentives. One study of a large firm found that automatic enrollment increased participation by eligible employees from 57 percent to 86 percent in 1 year for new hires. Brigitte C. Madrian and Dennis F. Shea, "The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior," *The Quarterly Journal of Economics*, vol. 116, issue 4 (November 2001).

Changes at Labor and IRS Could Help Encourage Employers to Offer IRAs and Improve IRA Information and Oversight

Earlier this month, we reported that changes at IRS and Labor could encourage employers to offer IRAs and improve IRA information and oversight.⁶ We found that regulators lack information about employer-sponsored and payroll-deduction IRAs that could help determine whether these vehicles help workers without employer-sponsored pension plans build retirement savings. For example, IRS collects information on employer-sponsored IRAs but does not share the information collected with Labor, which has oversight responsibility for employer-sponsored IRAs. We also found that certain oversight vulnerabilities need to be improved. Currently, Labor has no process in place to monitor employer-sponsored IRAs, and has no jurisdiction over payroll-deduction IRAs. As a result of our findings, we made recommendations to Labor and IRS to improve IRA information and oversight and suggested that Congress may wish to consider whether payroll-deduction IRAs should have some direct oversight.

Regulators Lack Information and Consistent Reporting on Employer-Sponsored and Payroll-Deduction IRAs

Because employer-sponsored IRAs have few employer reporting requirements and payroll-deduction IRAs have none, regulators lack information on these IRAs. Under Title I of ERISA, there is no reporting requirement for SIMPLE IRAs, and there is an alternative method available for reporting employer-sponsored SEP IRAs. Employers who offer payroll-deduction IRAs have no reporting requirements, and consequently, there is no reporting mechanism that captures how many employees offer payroll-deduction IRAs. Although IRS receives information reports for all traditional and Roth IRAs, those data do not show how many were for employees using payroll-deductions. In our discussions with Labor and IRS officials, they explained that the limited reporting requirements for employer-sponsored IRAs were put in place to try to encourage small employers to offer their employees retirement plan coverage by reducing their administrative and financial burdens.

Although the reporting requirements for employer-sponsored IRAs are limited, IRS does collect some information on these IRAs through several "information" forms provided by financial institutions and employers. These forms provide information on salary-reduction contributions to employer-sponsored IRAs, as well as information on IRA contributions, fair market value, and distributions. For example, information on retirement plans are reported annually by employers and others to IRS on

⁶GAO-08-230.

its Form W-2. The Form W-2 contains details on the type of plan offered by the employer, including employer-sponsored IRAs, and the amounts deducted from wages for contributions to these plans.³⁶

According to agency officials, IRS cannot share the information it receives on employer-sponsored IRAs with Labor because it is confidential tax information. Labor also does not receive relevant information from employers, such as annual financial reports, as it does from private pension plan sponsors. For example, pension plan sponsors must file Form 5500 reports with Labor on an annual basis, which provide Labor with valuable information about the financial health and operation of private pension plans.³⁷ Although Labor's Bureau of Labor Statistics National Compensation Survey surveys employee benefit plans in private establishments, receiving information on access, participation, and take-up rates for DB and DC plans, the survey does not collect information on the number of employers sponsoring employer-sponsored IRAs. Consequently, Labor does not receive important information on employees who have established employer-sponsored IRAs, over which it has oversight responsibilities.

Ensuring that regulators obtain information about employer-sponsored and payroll-deduction IRAs is one way to help them and others determine the status of these IRAs and whether those individuals who lack employer-sponsored pension plans are able to build retirement savings through employer-sponsored and payroll-deduction IRAs. However, key information on IRAs is currently not reported, such as information that identifies employers offering payroll-deduction IRAs and the distribution by employer of the number of employees that contribute to payroll-deduction IRAs. Experts that we interviewed said that, without such information, they are unable to determine how many employers and employees participate in payroll-deduction IRAs and the extent to which

³⁶ In addition to information collected through employer filed W-2 forms, the financial institution/trustee handling the employer-sponsored IRA provides the IRS and participants with annual statements containing contribution and fair market value information on IRS Form 5498. Distributions from that same plan are reported by the financial institution making the distribution to both IRS and the recipients of the distribution on IRS Form 1099-R.

³⁷ The Form 5500 provides basic information to identify the plan and type of plan as well as more detailed information, including data on assets, liabilities, insurance, and financial transactions. Form 5500 contains information on the financial condition of the plan and the benefits that the plan expects to pay out.

these IRAs have contributed to the retirement savings of participants. In addition, the limited reporting requirements prevent information from being obtained about the universe of employers that offer employer-sponsored and payroll-deduction IRAs, which affects Labor's ability to monitor employer-sponsored IRAs. This information also can be useful when determining policy options to increase IRA participation among uncovered workers because it provides a strong foundation to assess the extent to which these IRAs are being utilized.

Although IRS does publish some of the information it receives on IRAs through its Statistics of Income program, IRS does not produce IRA reports on a consistent basis. IRS officials told us that they are currently facing several challenges that affect their ability to publish IRA information more regularly. First, IRS relies, in part, on information returns to collect data on IRAs; such returns are not due until the following year after the filing of the tax return. IRS officials said that these returns have numerous errors, making it difficult and time-consuming for IRS to edit them for statistical analysis. They also said that the IRA rules, and changes to those rules, are difficult for some taxpayers, employers, and trustees to understand, which contributes to filing errors. Also, in the past, one particular IRS employee, who has recently retired, took the lead in developing a statistical analysis on IRAs. Since IRS does not have a process in place to train another employee to take over this role, a knowledge gap was created that IRS is trying to fill. IRS officials told us that they recognize this problem and are in the early stages of determining ways to correct it. In addition, IRS officials told us they had problems with the IRA data for tax year 2003, which prevented them from issuing a report for that year. The result has been that IRS has published IRA data for tax years 2000, 2001, 2002 and 2004, but none for tax year 2003.

Labor officials and retirement and savings experts told us that without the consistent reporting of IRA information by IRS, they use studies by financial institutions and industry associations for research purposes, which include assessing the current state of IRAs and future trends. These experts said that although these studies are helpful, some may double-count individuals because one person may have more than one IRA at different financial institutions. They also said that more consistent reporting of IRA information could help them ensure that their analyses reflect current and accurate information about retirement assets, such as the fair market value of IRAs. Since IRS is the only agency that has data on all IRA participants, consistent reporting of these data could give policymakers and others a more comprehensive view of the IRA landscape.

Labor Has No Process in Place to Monitor Employer-Sponsored IRAs

Given the limited reporting requirements for employer-sponsored IRAs and the absence of requirements for payroll-deduction IRAs, as well as Labor's role in overseeing employer-sponsored IRAs, a minimum level of oversight is important to ensure that employers are acting in accordance with the law and within Labor's guidance on payroll-deduction IRAs. Yet, Labor officials said that they are unable to monitor (1) whether all employers are in compliance with the prohibited transaction rules and fiduciary standards, such as by making timely and complete employer-sponsored IRA contributions or by not engaging in self-dealing;¹⁴ and (2) whether all employers who offer a payroll-deduction IRA are meeting the conditions of Labor's guidance.

- **Employer-sponsored IRAs.** Labor officials said that they do not have a process for actively seeking out and determining whether employer-sponsored IRAs are engaging in prohibited transactions or not abiding by their fiduciary responsibilities, such as by having delinquent or unremitted employer-sponsored IRA contributions. Instead, as in the case of Labor's oversight of pension plans, Labor primarily relies on participant complaints as sources of investigative leads to detect employers that are not making the required contributions to their employer-sponsored IRA.
- **Payroll-deduction IRAs.** Payroll-deduction IRAs are not under Labor's jurisdiction; however, Labor does provide guidance regarding the circumstances under which an employer may provide a payroll-deduction IRA program without being subject to the Title I requirements of ERISA. As long as employers meet the conditions in Labor's regulation and guidance, employers are not subject to the fiduciary requirements in ERISA Title I that apply to employer-sponsored retirement plans, such as 401(k) plans.¹⁵ IRS, also, does not have direct oversight over payroll-deduction IRA programs. IRS oversees the rules associated with the traditional and Roth IRAs that payroll-deduction programs may fund.

¹⁴Section 406(b) of ERISA and §4075 of the Internal Revenue Code prohibit a plan fiduciary from engaging in self-dealing, which is described as conduct by fiduciaries that consists of taking advantage of their position in a transaction and acting for their own interests rather than for the interests of the beneficiaries of the plan.

¹⁵According to Labor officials, if they become aware of an employer operating a payroll-deduction IRA that may not be following agency guidance, Labor will conduct an investigation to determine if the IRA should be treated as an ERISA pension plan. The IRA may become subject to the requirements of Title I of ERISA, which includes filing a detailed annual report (Form 5500) with Labor. Labor officials said this was done in an effort to ensure that plans are being operated and maintained in the best interest of plan participants.

through employee contributions. However, IRS does not have oversight over employer management of these programs.

Labor officials told us that they are not aware of employers improperly relying on the safe harbor regarding payroll-deduction IRAs. However, without a process to monitor payroll-deduction IRAs, Labor cannot be certain of the extent or nature of certain employer activities that may fall outside of the guidance provided by Labor.

Recent Recommendations Regarding IRAs

In order to improve oversight and information available on IRAs, we recently made several recommendations to Congress, Labor, and IRS, which are summarized in table 3.

Table 3: Recent GAO Recommendations Regarding IRAs

Target	Recommendations
Congress	Given the absence of direct oversight of payroll-deduction IRAs, we suggested that Congress may wish to consider whether payroll-deduction IRAs should have some direct oversight.
Labor	<p>Examine ways to better encourage employers to offer and employees to participate in payroll-deduction IRA programs that could include:</p> <ul style="list-style-type: none"> • determining the costs to employers for establishing such programs, • developing policy options to help employers defray these costs, and • evaluating whether modifications to its guidance are needed to encourage employers to offer payroll-deduction IRA programs. <p>Evaluate ways to determine whether employers who establish employer-sponsored IRAs and offer payroll-deduction IRAs are in compliance with the law and the safe harbor provided under Labor's regulations and Interpretive Bulletin 99-1, while taking employer burden into account.</p> <p>Evaluate ways to collect additional information on employer-sponsored and payroll-deduction IRAs, such as adding questions to the Bureau of Labor Statistics National Compensation Survey that provide:</p> <ul style="list-style-type: none"> • information sufficient to identify employers that offer payroll-deduction and employer-sponsored IRAs, and • the distribution by employer of the number of employees that contribute to payroll-deduction and employer-sponsored IRAs.
IRS	<p>Provide Labor with summary information on IRAs and information collected on employers that sponsor IRAs.</p> <p>Release its reports on IRA contributions, accumulations, and distributions on a consistent basis, such as annually.</p>

Source: GAO.

We reported that neither IRS nor Labor have direct oversight of payroll-deduction IRAs and that Congress may wish to consider whether payroll-deduction IRAs should have some direct oversight. Although Labor provides guidance regarding the circumstances under which employers may offer payroll-deduction programs without being subject to the Title I requirements of ERISA, Labor does not have jurisdiction to monitor

whether employers are managing such programs within the bounds of Labor's safe harbor. Similarly, IRS has responsibility over tax rules for establishing and maintaining traditional and Roth IRAs that may be funded through employee contributions from payroll-deduction programs; however, IRS also does not have authority to monitor employers offering these programs. We have reported that without direct oversight of payroll-deduction IRAs, employees may lack confidence that payroll-deduction IRAs will provide them with adequate protections to participate in such programs, which is particularly important given the increasing role that IRAs have in retirement savings. As such, we have suggested that Congress consider whether payroll-deduction IRAs should have some direct oversight.

We have also reported that it is important for Labor to have an accurate accounting of the costs to employers for managing payroll-deduction IRAs. In our review, we were unable to determine the actual costs to employers for managing a payroll-deduction IRA program. Some experts reported that such costs were significant, while others reported that they were minimal. Further, under Labor's guidance on payroll-deduction IRAs, employers may receive reasonable compensation for the cost of operating payroll-deduction IRA programs as long as such compensation does not represent a profit to employers. However, because the information on costs of managing such programs is lacking, Labor may be unable to readily determine if employers are receiving excessive compensation and if such programs fall outside the safe harbor and may be considered to have become ERISA Title I programs. Furthermore, without accurate cost estimates and a determination of what constitutes "reasonable compensation" to employers, employers may be reluctant to seek compensation from IRA service providers to defray the costs of operating a payroll-deduction IRA program.

Conclusions

Currently, IRAs play a major role in preserving retirement assets but a very small role in creating them. Although studies show that individuals find it difficult to save for retirement on their own, millions of U.S. workers have no retirement savings plan through their employer. Employer-sponsored and payroll-deduction IRAs afford an easier way for workers, particularly those who work for small employers, to save for retirement. They also offer employers less burdensome reporting and legal responsibilities than defined benefit pension plans and defined contribution plans, such as 401(k) plans. Yet, barriers exist, such as administrative costs, that may discourage employers from offering payroll-deduction IRAs. As federal agencies begin to determine the true cost of establishing payroll-deduction

IRAs, employers will have a better understanding of the costs and will be in a better position to evaluate whether they will be able to offer payroll-deduction IRAs to their employees.

Encouraging employers to offer IRAs to their employees can be much more productive if Congress and regulators ensure that there is adequate information on employer-sponsored IRAs and payroll-deduction IRAs. Although the limited reporting requirements for employer-sponsored IRAs and the absence of reporting requirements for payroll-deduction IRAs were meant to encourage small employers to offer retirement savings vehicles to employees, there is also a need for agencies that are responsible for overseeing retirement savings vehicles to have the information necessary to do so. Providing complete and consistent data on IRAs would help ensure that regulators have the information they need to make informed decisions about how to increase coverage and facilitate retirement savings. In addition, ensuring that Labor has a process in place to monitor employer-sponsored IRAs will help ensure that there is a structure in place to help protect individuals' retirement savings if they choose employer-sponsored IRAs. If current oversight vulnerabilities are not addressed, future problems could emerge as more employers and workers participate in employer-sponsored IRAs.

Steps must also be taken to improve oversight of payroll-deduction IRAs and determine whether direct oversight is needed. Without direct oversight, employees may lack confidence that payroll-deduction IRAs will provide them with adequate protections to participate in these programs, which is particularly important given the current focus in Congress on expanding payroll-deduction IRAs. However, any direct oversight of payroll-deduction IRAs should be done in a way that does not pose an undue burden on employers or their employees.

We are continuing our work on IRAs, and are beginning to examine the fees that are charged IRA participants. We are pleased that the Committee on Ways and Means and this subcommittee are interested in retirement savings, particularly IRAs, and look forward to continuing our work with you.

Mr. Chairman and Members of the subcommittee, this completes my prepared statement and I would be happy to respond to any questions the subcommittee may have at this time.

Contacts and Acknowledgments

For further information regarding this testimony, please contact Barbara D. Boytjerg, Director, Education, Workforce, and Income Security Issues at (202) 512-7215 or boytjergb@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Individuals making key contributions to this testimony include Tamara Cross (Assistant Director), Matt Baranica, Susan Pachikara, Russ Lazier, Joseph Applebaum, Susan Aschoff, Doreen Feldman, Edward Nansenhorn, MaryLynn Serpent, Roger Thomas, Walter Vance, and Jennifer Wong.

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Chairman NEAL. You certainly can.
Mr. Campbell.

STATEMENT OF BRADFORD P. CAMPBELL, ASSISTANT SECRETARY OF LABOR, EMPLOYEE BENEFITS SECURITY ADMINISTRATION, U.S. DEPARTMENT OF LABOR

Mr. CAMPBELL. Thank you, Mr. Chairman. Chairman Neal, Ranking Member English, and the other Members of the Subcommittee, I very much appreciate the opportunity to come here today to discuss the Department's efforts to promote and also protect the interests of workers in employer-sponsored IRAs.

My name is Bradford Campbell, I am the Assistant Secretary of Labor for the Employee Benefit Security Administration. Our mission is to protect the retirement security of—the security of retirement health and other employer-provided benefits in the private sector. We are committed to promoting policies that encourage retirement savings, and protect employer-sponsored benefits.

Employers today can choose from an array of retirement plan designs that were created by Congress to make it easier for Americans to save. IRAs are an important vehicle among these options that may encourage small employers, in particular, to provide retirement programs for their workers. Employer-sponsored IRAs, such as SEPs and SIMPLEs are employee benefit plans under ERISA that were designed specifically to address these concerns of small businesses.

The Department has jurisdiction over employer-sponsored IRAs, and is responsible for their oversight and for their compliance with ERISA's fiduciary standards. In our oversight role, we employ a comprehensive, integrated approach which encompasses programs for: compliance assistance; interpretative guidance; prohibited transaction exemptions; education and outreach to small businesses, as well as workers; enforcement and participant assistance directly to workers who have questions about their plans.

By contrast, payroll deduction IRAs are not employer-sponsored plans subject to ERISA, but are individually owned IRAs that merely make use of an employer's payroll process to withhold and forward contributions to the individual's IRA. Our guidance that we issued helps employers ensure that their payroll deduction arrangements are not ERISA plans, and therefore, do not carry with them the associated reporting burdens, and so forth, as Congress intended. But, as with other individual IRAs, the IRS oversees and enforces the law with respect to payroll deduction IRAs.

The Department believes that this current oversight structure for IRA retirement programs is appropriate, and we would oppose changes in current law that would shift to the Department the oversight of retirement programs that are not employer-sponsored, such as payroll deduction IRAs.

We have devoted significant resources to assisting small employers in choosing a retirement program through comprehensive education and outreach and regulatory programs. These initiatives include publications that we have developed, in consultation with the IRS. I have a few of them here today: "Choosing a Retirement Solution for your Small Business" is one; "SEP Retirement Plans for Small Businesses;" "Simple IRA Plans for Small Businesses;" and

also a “Payroll Deduction IRAs for Small Businesses,” which helps employers know how to structure these arrangements.

We have also recently issued a DVD which goes through the real-life experiences of several small employers, as they evaluated their operations and decided which of these plans to choose. We have partnered with the American Institute of Certified Public Accountants, as well as the Chamber of Commerce and some other organizations, to help us reach out to small businesses to work with them and their service providers to make plans more available.

We also have a very active participant assistance program that helps individuals with their benefits questions and problems. Our benefits advisors provide information, but they also seek informal resolution of complaints. If appropriate, they refer those complaints on for investigation.

Since October of 2006, our benefits advisors have resolved 183 complaints involving missing contributions to SIMPLE and SEP IRAs and, through informal dispute resolution, recovered just over \$1 million on behalf of about 1,000 workers.

In addition, these complaints resulted in 157 cases referred for investigation.

Now, we match our enforcement—or our outreach and our assistance with very strong enforcement and oversight. Overall, EBSA, which, in our mission of protecting all employer-provided benefits, has been reporting results in recent years that are nearly double those of the previous years. Last year we had about 1.5 billion in civil results, and about 115 criminal indictments resulting from our investigations. Since 2001, that has been approximately 11 billion in civil results, and over 800 criminal indictments.

With respect to SIMPLE and SEP IRAs, in the past 3 fiscal years we have had enforcement results of about 1.2 million. Most of those violations involved the failure to forward contributions, or failure timely forward contributions to the IRA.

Given the size of the employer-sponsored plan and IRA universe, we believe that our integrated approach is effective, very effective, in providing compliance assistance, interpretative guidance, and strong enforcement. We work closely with the IRS and the Treasury Department to conduct enforcement, as well as to reach out to employers.

So, thank you for the opportunity to testify today. We are committed to promoting retirement programs, and to helping employers understand the options that Congress has provided for them, and ensuring the security of savings under our jurisdiction. Thank you.

[The prepared statement of Mr. Campbell follows:]

**TESTIMONY OF BRADFORD P. CAMPBELL
ASSISTANT SECRETARY OF LABOR
BEFORE THE
COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON SELECT REVENUE MEASURES
U.S. HOUSE OF REPRESENTATIVES**

June 26, 2008

Introductory Remarks

Good morning, Chairman Neal, Ranking Member English, and Members of the Subcommittee. Thank you for inviting me to discuss IRAs and the Department of Labor's role in promoting and overseeing employer-sponsored IRAs. I am Bradford Campbell, Assistant Secretary of Labor for the Employee Benefits Security Administration (EBSA). I am proud to be here today representing the Department of Labor and EBSA. Our mission is to protect the security of retirement, health and other private sector, employer-provided benefits for America's workers, retirees and their families.

EBSA is committed to promoting policies that encourage retirement savings and protect employer-sponsored benefits. Employers today can choose from an array of retirement plan design options created by Congress to make it easier for employers to help America's workers build retirement savings. IRAs are an important vehicle among those options that may encourage small employers to provide retirement programs for their employees.

Employer-sponsored IRAs are employee benefits plans designed by Congress specifically to address the concerns of small businesses regarding the affordability and feasibility of offering a retirement plan. By contrast, payroll-deduction IRAs are individually-owned IRAs that offer employers a simple and direct way to help their employees to save for retirement without actually sponsoring a plan. These payroll deduction IRAs generally are not employer-sponsored plans subject to the Department's jurisdiction. EBSA has

provided clear guidance related to what employer actions would cause a payroll-deduction IRA to become subject to ERISA's rules.

Where IRAs are under our jurisdiction, our enforcement program works diligently to protect the retirement savings of workers, retirees and their families.

Background

EBSA is responsible for administering and enforcing the fiduciary, reporting, and disclosure provisions of Title I of ERISA. The Department generally does not have jurisdiction over IRAs except to the extent they are employer-sponsored.

Types of Employer-sponsored IRAs

Employer-sponsored IRAs primarily consist of Simplified Employee Pensions (SEPs) and Savings Incentive Match Plans for Employees (SIMPLE IRAs). These plans have the dual benefits of higher maximum annual contributions than IRAs that are not employer sponsored and no annual reporting requirements for sponsoring employers under ERISA.¹ SEP and SIMPLE IRA plan designs require employer contributions and require the employer to offer enrollment to all employees who meet participation requirements.

Most employers with one or more employees can establish a SEP. SEPs have the benefit of low start-up and operating costs and can be established using a two-page IRS Form 5305-SEP. No ongoing reporting is required. While employers are required to contribute a uniform percentage of pay for each employee, they do not have to make contributions every year which provides flexibility when business conditions vary. For 2008, employer contributions are limited to the lesser of 25 percent of pay or \$46,000.

¹Annual reports are not required to be filed under ERISA by an employer maintaining any SIMPLE IRA established pursuant to section 408(p) of the Internal Revenue Code. ERISA § 101(h)(1). In the case of a SEP described in section 408(k) of the Code, Department regulations provide for alternative methods of compliance with the reporting and disclosure requirements of Title I of ERISA, including by the use of simple IRS Form 5305-SEP.

SIMPLE IRAs are for employers with 100 or fewer employees. These plans allow employees to contribute a percentage of their salary each paycheck and require employer contributions. Under SIMPLE IRA plans, employees can contribute up to \$10,500 in 2008, and additional catch-up contributions up to \$2,500 for participants over age 50. Employers must either match employee contributions dollar for dollar, up to 3 percent of an employee's compensation, or make a fixed contribution of 2 percent of compensation for all eligible employees. SIMPLE IRAs are easy for employers to set up by using IRS Forms 5304-SIMPLE or 5305-SIMPLE, and no ongoing reporting is required.

Payroll-deduction IRAs

Payroll-deduction IRAs provide employers who do not want to sponsor a retirement plan and become subject to ERISA's fiduciary and reporting requirements a way to allow employees to contribute to their own IRAs through payroll deductions. Any employer can set up one of these arrangements. Payroll-deduction IRAs provide a simple and direct way for eligible employees to save, deciding for themselves whether and how much to contribute up to IRA contribution limits (up to \$5,000 for 2008 and \$1,000 for catch-up contributions). For employees, payroll-deduction IRAs provide an easy way to save smaller amounts each pay period. For employers, they are easy to set up, and only require transmitting contributions for employees to the IRA. There are no employer contributions, and no annual filing requirement under ERISA or minimum coverage requirements. Keeping payroll-deduction IRAs as simple as possible and free of unnecessary reporting requirements is vital to encouraging small employers to make their payroll systems available to help employees save for retirement.

EBSA has provided a roadmap in the form of a "safe harbor" to make it easy for employers to construct and administer a payroll-deduction arrangement which would not create an "employer sponsored" plan. Under the guidance,² if an employer maintains its neutrality with respect to an IRA sponsor by not endorsing that sponsor and simply limits

² Interpretive Bulletin 99-1 (29 CFR 2509.99-1).

its involvement to collecting deducted amounts and remitting them to the IRA, the IRA will not be sponsored by the employer and will not be an ERISA-covered plan. The guidance clarifies that employers may reduce any administrative burden presented by a payroll deduction IRA by selecting one IRA sponsor to receive payroll contributions, and may be reimbursed by the IRA sponsor for the actual costs of operating the IRA payroll-deduction program.

The GAO report, "Individual Retirement Accounts: Government Actions Could Encourage More Employers to Offer IRAs to Employees," states that according to IRA providers, some employers are concerned that publicizing the availability of a payroll deduction IRA to their employees might be seen as an endorsement of an IRA provider, making the payroll deduction IRA subject to ERISA. While the Department has not received similar comments from employers or IRA sponsors, the Department's guidance does address this issue. The guidance states that an employer may encourage an employee to save for retirement through payroll withholding and contribution to an IRA, and provide informational materials written by the IRA sponsor without making the IRA a pension plan subject to Title I of ERISA.

Oversight of IRAs by the Department of Labor and the IRS

The Department has jurisdiction over employer-sponsored IRAs and is responsible for oversight of their compliance with ERISA's fiduciary standards. In EBSA's oversight role, we employ a comprehensive, integrated approach encompassing programs for compliance assistance, interpretive guidance, prohibited transaction exemptions, education and outreach, and enforcement.

The GAO report notes that the IRS is responsible for tax rules that govern establishing and maintaining all IRAs, including payroll-deduction IRAs. The report also notes that IRS is responsible for oversight of IRAs through assessment of excise taxes on persons who engage in prohibited transactions with IRAs. Generally, prohibited transactions are transactions such as loans, leases, sales between the IRA and a related party. If a

prohibited transaction involves self-dealing by the IRA owner, the IRA is disqualified from favorable tax treatment. The Department has interpretive authority over the prohibited transaction rules in the Internal Revenue Code and is available to provide interpretive assistance to the IRS. The Department also has sole jurisdiction over the granting of prohibited transaction exemptions for all IRAs.

As I explained earlier, payroll-deduction IRAs are not employer-sponsored plans subject to the requirements imposed on plans by Title I of ERISA. Accordingly, they are not subject to the Department's oversight. IRAs not subject to Title I of ERISA are, however, generally subject to oversight by the IRS and applicable state laws that could directly regulate payroll deductions, IRAs, or persons who provide services to IRAs.

Thus, the IRS provides oversight for individual IRAs and payroll deduction IRAs, and the Department provides oversight for employer-provided IRAs subject to Title I of ERISA. The Department believes the current oversight structure for IRA retirement programs that are not employer-sponsored is appropriate, and would oppose changes in current law that would shift to the Department oversight of retirement programs that are not employer-sponsored, such as payroll-deduction IRAs. The Department has provided guidance to assist employers who want to ensure that payroll-deduction IRAs made available to their employees are not subject to Title I of ERISA. The safe harbor guidance is straightforward and easy for employers to meet. To charge the Department with oversight would defeat the safe harbor's purpose and could discourage these employers from providing their employees opportunities to save for retirement.

The GAO report states that there is a gap in the data available for IRAs. In our response letter to GAO, we pointed out that in creating SIMPLE IRAs, Congress weighed the benefits of promoting retirement savings and the burdens of reporting requirements, and decided to limit reporting requirements for these employer-sponsored IRAs. We strongly agree with the policy goal reflected in the law that small employers should be encouraged to provide retirement programs and should not be overly burdened.

EBSA Compliance Assistance, Education and Outreach Activities

EBSA believes that some of the best ways to encourage small employers to provide retirement savings opportunities for their employees using the vehicles Congress has made available is through compliance assistance and education and outreach activities. EBSA provides compliance assistance and guidance to help employers understand their fiduciary and reporting responsibilities for employer-sponsored plans under Title I of ERISA. EBSA has also devoted significant resources to assist small employers in choosing a retirement program, through comprehensive education and outreach,³ and regulatory programs.

EBSA's education and outreach program focuses on providing information on the various retirement savings options to small businesses with no retirement plan. These initiatives include publications as well as seminars, a DVD providing the peer perspective from employers that sponsor the most popular plans, such as SIMPLE IRAs and SEPs, and an interactive website. Specific publications, which EBSA developed in conjunction with the IRS, include "Choosing a Retirement Solution for Your Small Business," "Payroll Deduction IRAs for Small Business," "SEP Retirement Plans for Small Business," and "SIMPLE IRA Plans for Small Business."

The Department partners with the American Institute of Certified Public Accountants to reach accountants of small businesses to assist them in their role in the small business owner's decision to set up a plan. The Department also works with local Chambers of Commerce and other organizations to reach small businesses directly.

EBSA also has a very active participant assistance program that helps people with their benefits questions and problems. Our Benefits Advisors provide information, but also seek informal resolution of complaints, and if appropriate, refer cases for investigation. Since October 2006, EBSA's Benefits Advisors have resolved 183 complaints involving

³ Section 516 of ERISA requires the Department to maintain a program designed to effectively promote retirement income savings by the public, including information on the forms of retirement income savings.

missing contributions to SIMPLE & SEP IRAs through informal dispute resolution, recovering \$1.07 million on behalf of 1001 participants. In addition, 157 investigations were opened as a result of Benefits Advisor referrals.

EBSA's Enforcement Efforts

Ensuring the security of employees' retirement benefits under the Department's jurisdiction is a core mission of EBSA. EBSA operates an aggressive enforcement program to protect the benefits of workers, retirees and their families. We rely on targeting to focus our enforcement resources in an effective manner and to ensure that employers act in accordance with the law. "Targeting" is the process whereby specific individuals or entities are identified for investigation because of some indication that an ERISA violation may have occurred or may be about to occur.

EBSA believes that its methods of selecting cases have been very successful, as EBSA has consistently reported enforcement results nearly double those of just a few years ago. In FY 2007 alone, EBSA's activities for all pension, health and other welfare benefit plans yielded \$1.5 billion in monetary results and EBSA's investigations led to the indictment of 115 persons for criminal activity related to employee benefit plans. Since 2001, EBSA has achieved nearly \$11 billion in monetary results and more than 800 criminal indictments.

With respect to those investigations involving employer-sponsored IRAs, EBSA primarily targets through participant complaints. During the past three fiscal years, EBSA investigated 170 SIMPLE IRA and SEP plans and obtained monetary results of approximately \$1.2 million. The majority of the violations EBSA detected involved the failure to remit employee or employer contributions to the plan.

In its report, GAO expresses concern that EBSA is unable to monitor whether all employers that sponsor IRAs are in compliance with the law. It goes on to recommend that the Department evaluate ways to determine whether employers who establish

employer-sponsored IRAs and offer payroll-deduction IRAs are in compliance with the law.

Given the size of the employer-sponsored plan and IRA universe, EBSA believes that its current integrated approach encompassing programs for compliance assistance, interpretive guidance, education and outreach, and targeting in enforcement is the most effective use of the agency's resources. In particular, EBSA believes that it would not be an effective use of agency resources to randomly monitor payroll-deduction IRAs for compliance with our guidance. If GAO's concern is that employers maintaining payroll-deduction IRAs could be failing to transmit payroll contributions, enforcement of these violations would be under the jurisdiction of the IRS and states.

Conclusion

Mr. Chairman and Members of the Committee, thank you for the opportunity to testify before you today. The Department is committed to promoting retirement programs and to helping employers understand the various options that Congress has made available to support retirement savings. We are also committed to ensuring the security of IRA savings under our jurisdiction. I will be pleased to answer any questions you may have.

Chairman NEAL. Thank you, Mr. CAMPBELL
Mr. Reeder.

**STATEMENT OF W. THOMAS REEDER, BENEFITS TAX COUNSEL,
OFFICE OF TAX POLICY, U.S. DEPARTMENT OF THE
TREASURY**

Mr. REEDER. Chairman Neal, Ranking Member English, and Members of the Committee, thank you for the opportunity to appear today to testify on IRAs and their vital role in generating and maintaining retirement savings of American workers and their beneficiaries.

The IRA has been an important retirement savings tool since 1975. IRAs are now available to all Americans with compensation income. Certain tax preferences of IRAs, however, are dependent on the individual's level of income, and whether the individual is covered by an employer-sponsored retirement plan.

As more fully described in my written testimony, there are several types of IRAs, including two special IRAs that can be sponsored by employers. IRAs are particularly valuable to those individuals who do not have access to other employer-sponsored savings plans, and also operate as a portable entity into which employees can combine and efficiently manage the retirement savings they have accumulated over their working careers.

The Administration remains committed to educating employers about all their retirement plan options. Although the large employers typically sponsor workplace retirement savings programs, such as 401(k)'s, 403(b)'s, 457 plans, many employers lack the knowledge or the resources to adopt and maintain these plans.

Along with the Department of Labor, the Treasury Department and the IRS have taken significant steps to publicize the advantages of employer-sponsored IRA-based savings programs, and to educate employers and individuals on the ease of setting them up.

For example, the IRS has developed a model plan document for SIMPLE IRAs and SEPs, and has created a number of publications and online resources, many in cooperation with the Department of Labor, as Mr. Campbell has just testified.

The Administration has long been concerned that the rules of employer retirement savings plans are unreasonably complicated. This complexity imposes substantial compliance, administrative and enforcement costs on employers, participants, and the government, and hence, the taxpayers in general.

Moreover, because employer sponsorship of a retirement plan is voluntary, this complexity discourages many employers, and especially small employers, from offering a plan at all. Complexity is commonly cited as a reason the coverage rate of employer-sponsored plans has not grown above 50 percent overall, and has remained below 25 percent among employees of smaller firms.

To address the hurdles employers face in trying to establish savings plans for their employees, the Administration's budget includes a proposal for an employer retirement savings account, or ERSA, to combine the various types of employer-sponsored savings plans to a single type of plan with simplified administrative rules for small employers.

The Administration has also proposed a significant simplification of individual IRAs to create just two types of IRAs with extremely simple distribution rules: one that can be used for any purpose at all; and the other would be just for retirement. Of course, the Administration will be open to other proposals that decrease the complexity or administrative burden on small employers who want to provide savings opportunities for their employees.

While the Treasury Department and the IRS have been promoting employer-sponsored retirement savings programs, and developing new ideas to make plan sponsorship even easier, we are concerned about the prospect of imposing mandatory requirements that could affect the ability of an employer, particularly a small employer, to run its business efficiently, and compete effectively in its marketplace. Operating a business already involves a significant amount of investment. Adding yet another burden could have an adverse effect, particularly on small employers, which are so essential to the success of our economy.

Moreover, mandating a particular benefit on small employers, particularly to the extent such benefits impose a significant cost on the employer, could affect the employer's decision to offer other employee benefits that may be more relevant to the employer's work force, particularly health coverage.

In conclusion, we should not lose sight of the fact that the IRA generally is not as powerful a retirement savings tool as other tax-qualified retirement plans, such as the 401(k), the 403(b), other defined contribution plans and defined benefit plans. This is primarily because the restriction on pre-retirement distributions in such other plans avoids much of the pre-retirement leakage that occurs in IRAs. We should not encourage the adoption of IRA programs by employers that are willing and able to adopt plans that are a better deal for their employees.

Mr. Chairman and Members of the Committee, thank you for the opportunity to testify, and I look forward to answering any questions.

[The prepared statement of Mr. Reeder follows:]



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TESTIMONY OF TREASURY BENEFITS TAX COUNSEL THOMAS REEDER BEFORE THE HOUSE WAYS AND MEANS SUBCOMMITTEE ON SELECT REVENUE MEASURES ON INDIVIDUAL RETIREMENT ARRANGEMENTS

Washington, DC—Chairman Neal, Ranking Member English and Members of the Committee, I appreciate the opportunity to appear today to discuss the issue of individual retirement arrangements (IRAs) and their vital role in generating and maintaining retirement savings of American workers and their beneficiaries.

Background

IRAs are available to all Americans with compensation income (including net earnings from self-employment involving personal services). Certain tax preferences of IRAs, however, are dependent on the individual's level of income and whether the individual is covered by an employer-sponsored retirement plan. There are several types of IRAs, including traditional deductible IRAs, traditional nondeductible IRAs, and Roth IRAs. In addition, there are special types of IRAs available in the employment context referred to as SEP IRAs and SIMPLE IRAs.

Individuals under age 70½ may make contributions to a traditional IRA, subject to certain limits. The contributions are generally deductible. The deduction is phased out, however, for workers with incomes above certain levels who are covered by an employer-sponsored retirement plan. For taxpayers covered by employer plans in 2008, the deduction is phased out for single and head-of-household filers with modified adjusted gross income¹ (AGI) between \$53,000 and \$63,000, for married couples filing jointly with AGI between \$85,000 and \$105,000, and for married couples filing separately with AGI between \$0 and \$10,000. For a married individual filing jointly who is not covered by an employer-sponsored plan, but whose spouse is covered, the deduction is phased out between \$159,000 and \$169,000 in AGI. IRA earnings are not includible in gross income until distributed. Distributions (including both pre-tax contributions and account earnings) are includible in gross income for income tax purposes.

¹Modified adjusted gross income for this purpose is adjusted gross income plus income from education savings bonds, interest paid on education loans, employer-provided adoption assistance benefits, IRA deductions, deductions for qualified higher education expenses, and certain other adjustments.

To the extent a taxpayer cannot or does not make deductible contributions to a traditional IRA, a taxpayer under age 70½ may make nondeductible contributions. Distributions representing a return of basis are not includible in gross income, while distributions representing account earnings are includible in gross income. There is no income limit for nondeductible contributions to a traditional IRA.

Individuals of any age with sufficiently low income may make contributions to a Roth IRA. The contributions are not deductible. Allowable contributions are phased out for workers with incomes above certain levels. In 2008, contributions are phased out for single or head-of-household filers with AGI between \$101,000 and \$116,000, for married couples filing jointly with AGI between \$159,000 and \$169,000, and for married couples filing separately with AGI between \$0 and \$10,000. Account earnings accumulate tax free, and qualified distributions (including account earnings) are not included in gross income for income tax purposes. Distributions from Roth IRAs prior to age 59½ or before the individual has had a Roth IRA for 5 years are included in income to the extent they exceed basis, unless the distribution is on account of death or disability or, for an amount up to \$10,000, for a first-time home purchase. Distributions are deemed to come from basis first.

The annual aggregate limit on contributions to all of a taxpayer's IRAs (traditional, nondeductible, and Roth) is the lesser of earnings or \$5,000 in 2008, and will be indexed for price inflation after 2008. Individuals age 50 and over may make an additional "catch-up" contribution of up to \$1,000.

Taxpayers (other than married taxpayers who file separately) with AGI of \$100,000 or less can convert a traditional IRA to a Roth IRA. In general, the conversion amount is included in gross income (but not for purposes of determining eligibility to convert). The Tax Increase Prevention and Reconciliation Act of 2005 repealed the income limitation for conversions from a traditional IRA to a Roth IRA made after December 31, 2009. Taxpayers who make such conversions in 2010 may elect to delay half of the income inclusion resulting from the conversion to 2011 and the other half of the income inclusion to 2012. Conversions made on or after January 1, 2011 will result in the full amount of the converted amount not previously included in taxable income to be included in the year of the conversion.

Distributions from traditional IRAs prior to age 59½, or from Roth IRAs prior to age 59½ or 5 years after the first Roth contribution, are generally subject to an additional 10 percent income tax. The tax is imposed on the portion of an early distribution that is includible in gross income. It applies in addition to ordinary income taxes on the distribution. The additional tax does not apply to a rollover to an employer plan or to another IRA, or if the distribution is made in the case of death or disability, certain medical expenses, first-time homebuyer expenses, qualified higher-education expenses, health insurance expenses of unemployed individuals, to a qualified reservist, or as part of a series of substantially equal periodic payments.

Beginning at age 70½, minimum distributions gauged to life expectancy of the IRA holder (or the joint life expectancy of the IRA holder and beneficiary) must be taken from a traditional IRA. Roth IRAs are not subject to minimum distribution rules during the account owner's lifetime.

Employers with 100 or fewer employees and no other retirement plan may establish SIMPLE IRAs. Unlike traditional IRAs, participants may defer up to \$10,500 and SIMPLE participants aged 50 or over may make additional "catch-up" deferrals of up to \$2,500. All contributions are immediately fully vested. In lieu of the nondiscrimination tests applicable to most other employer-sponsored retirement savings plans, SIMPLE IRAs are subject to special contribution rules, including a lower annual elective deferral limit and either a matching employer contribution for each employee up to 3 percent of compensation (which may be reduced to 1 percent under certain circumstances) or non-elective contribution of 2 percent of all eligible employees' compensation.

An employer may contribute to its employees' IRAs under a simplified employee pension (SEP). Under a SEP, the employer must contribute to all employees' IRAs in the same percentage (with certain exceptions). Employee contributions to SEPs are not permitted, except with respect to grandfathered salary reduction SEPs that were in existence on December 31, 1996.

An employer may also establish payroll deduction IRAs under which employees may elect to have a portion of their pay contributed to a traditional or Roth IRA in any amount up to the annual limits for individual traditional or Roth IRAs (plus the catch-up amount, if applicable). Like a SIMPLE IRA, these may be set up on an automatic basis. That is, the employee may be deemed to elect to participate in the program at a certain level unless the employee affirmatively elects not to participate or to participate at a different level. Although a payroll deduction IRA is essentially the same as an individual IRA, there are tremendous advantages to the payroll deduction process. It is generally accepted that employees are more likely to save if the amounts are automatically diverted to an IRA before they reach the employee's hands or checking account.

In summary, IRAs provide a valuable long-term savings tool. They are particularly valuable to those individuals who do not have access to other employer-sponsored savings plans and they are quite useful as a portable entity into which employees can combine the retirement savings they amass over their working careers. With all their retirement assets in a single trust or custodial account, employees can more efficiently and cost-effectively diversify their investments and otherwise manage their retirement savings.

Interpretive and Enforcement Authority over IRAs

The Treasury Department and the Internal Revenue Service (IRS) generally have interpretive and enforcement authority over the establishment and operation of individual IRAs and payroll deduction IRAs. The Employee Benefits Security Administration (EBSA) of the Department of Labor, however, has jurisdiction over various aspects (including fiduciary and disclosure requirements) of SEP IRAs and SIMPLE IRAs, as well as certain payroll deduction IRAs that entail such employer involvement that they constitute an employee benefit plan under Title I of the Employee Retirement Income Security Act of 1974. EBSA also has jurisdiction with respect to the interpretation of the prohibited transaction rules applicable to IRAs and has statutory authority to issue individual and class exemptions from the prohibited transaction rules for transactions involving IRAs.²

Treasury Department Activities Promoting Employer-Sponsored Savings Programs

The Administration has long been concerned that the rules of employer retirement savings plans are unreasonably complicated. This complexity imposes substantial compliance, administrative, and enforcement costs on employers, participants, and the government (and hence, taxpayers in general). Moreover, because employer sponsorship of a retirement plan is voluntary, this complexity discourages many employers from offering a plan at all. This is especially true of small employers, which employ a majority of American workers. Complexity is commonly cited as a reason the coverage rate of employer-sponsored plans has not grown above about 50 percent overall and has remained under 25 percent among employees of small firms. Thus, the Administration is dedicated to reducing the complexity through proposed legislation and providing tools for employers – especially small employers – to use in creating and administering plans.

² For example, if a non-exempted prohibited transaction occurs, under rules enforced by the IRS, an excise tax would apply. If the prohibited transaction involves the IRA-owner or a beneficiary of the IRA, the balance in the IRA would be subject to income tax.

The Administration continues to be dedicated to educating employers about retirement plan options. Although most large employers sponsor workplace retirement savings programs, such as 401(k), 403(b), or 457 plans, many small employers lack the knowledge or resources to adopt these plans. Along with the Department of Labor, the Treasury Department and the IRS have taken significant steps to publicize the advantages of employer-sponsored IRA-based savings programs and to educate employers and individuals on the ease of setting them up. For example, the IRS has developed model plan documents for SIMPLE IRAs and SEPs and has created the following publications:

- o *Retirement Plans for Small Business* (SEP, SIMPLE, and Qualified plans) (Publication 560)
- o *Individual Retirement Arrangements* (Publication 590)
- o *Choosing a Retirement Solution for Your Small Business* (co-produced by the IRS and EBSA) (Publication 3998)
- o *SEP Retirement Plans for Small Businesses* (co-produced by the IRS and EBSA) (Publication 4333)
- o *SIMPLE IRA Plans for Small Businesses* (co-produced by the IRS and EBSA) (Publication 4334)
- o *SIMPLE IRA Plan Checklist* (Publication 4284)
- o *SEP Checklist* (Publication 4285)
- o *Have you had your checkup this Year? For SIMPLE IRAs, SEPs and Similar Retirement Plans* (Publication 4405)

In addition to these publications, the IRS operates an extensive on-line resource for IRA-based retirement plans for small employers, "The IRA Online Resource Guide," which is also available as a CD-ROM. There is also video entitled "How to Set up a Retirement Plan for Yourself and Your Employees" available on the IRS online classroom site for small businesses (www.irs.gov/businesses/small). Of particular note is the Retirement Plan Navigator geared to small employers (http://www.irs.gov/pub/irs-sege/online_navigator.pdf), which includes a video and leads small employers through the process of choosing a type of plan and goes through the process of adopting and maintaining the plan.

The Employee Plans division of the IRS participated in over 300 events last year throughout the country, many of which are directed at small employers and their advisors. The IRS has partnered with various groups, including the United States Chamber of Commerce, the National Federation of Independent Business, and the Small Business Administration, in putting together materials and events for small employers.

One of the key features that makes employer-sponsored IRAs attractive to small employers with limited resources is the fact that the employer is not required to file annual reports with the Department of Labor or the IRS. This feature, however, makes it more difficult to determine precisely how many employers are adopting them and how many employees participate. Requiring more reporting would make it harder for employers with limited administrative resources to adopt employment-based IRA programs. But the IRS has data on the level of individual contributions and year-end account balances because those data are reported to the IRS by the IRA custodian. In 2004, contributions were made to the SEP IRAs of 1.6 million taxpayers in an amount of \$13.8 billion, or approximately \$8,625 per taxpayer. This amount was 28.2 percent of all IRA contributions in 2004. Contributions were made to the SIMPLE IRAs of 1.9 million taxpayers, in the amount of \$7.6 billion, or about \$4,000 per taxpayer. This amount was 15.6 percent of all IRA contributions in 2004. As of the end of the 2004, 3.5 million taxpayers held \$169 billion in SEP IRAs and 2.5 million taxpayers held \$34 billion in SIMPLE IRAs. This difference is likely due to the fact that SEP accounts are very common in businesses in which only the owner

participates, have much higher contribution limits than SIMPLE IRAs, and have been in existence much longer than SIMPLE IRAs.¹

Legislative Proposals

Because the Administration has been concerned about the hurdles employers face in trying to establish savings plans for their employees, the Administration's Budget has included for the past several years a proposal (the "Employer Retirement Savings Account" or ERSA) to combine the various types of employer-sponsored savings plans into a single type of plan (with simplified administrative rules for small employers). Of course the Administration would be open to other proposals that decrease the complexity or administrative burden on small employers that want to provide savings opportunities for their employees.

While the Treasury Department and the IRS have been promoting employer-sponsored retirement savings programs and developing new ideas to make plan sponsorship easier, we are concerned about imposing mandatory requirements that could affect the ability of an employer, particularly a small employer, to run its business efficiently and compete effectively in its marketplace. Operating a business already involves a significant amount of investment (typically the employer's time and money) and adding yet another stringent requirement could have an adverse effect, particularly on small employers, which are an essential sector of America's economy. Moreover, mandating a particular benefit on small employers, particularly to the extent such benefits imposes a significant cost on the employer, could affect the employer's decision to offer other employee benefits that may be more relevant for the employer's workforce, particularly health coverage.

Finally, we should not lose sight of the fact that IRAs generally are not as powerful of a retirement savings tool as other tax-qualified retirement plans, such as 401(k), 403(b) and other defined contribution plans and defined benefit plans. This is primarily because the restriction on pre-retirement distributions in such plans avoids much of the pre-retirement leakage that occurs in IRAs. We should not encourage employers to adopt IRA programs if they are instead willing and able to adopt these more sophisticated and flexible retirement plans to benefit their employees.

Conclusion

Mr. Chairman and Members of the Committee, thank you for the opportunity to appear today, and I will be happy to respond to any questions.

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¹ SEPs have been available since 1979, while SIMPLE IRAs have been available only since 1997.

Chairman NEAL. Thank you, Mr. Reeder. Ms. Bovbjerg, you have offered a very interesting chart on page 13, which shows how easy payroll deduction IRAs are for employers: no reporting, no matching, et cetera. But still, usage is very limited.

Do you think if there were credits to offset some of the administrative costs, we might see greater participation by employers?

Ms. BOVBJERG. One would hope so, since we heard so much about administrative costs when we were interviewing various stakeholders in this system.

But, at the same time, one of the things we heard was that, despite all the effort that, clearly, the Department of Labor has made, to make these types of arrangements known to small employers, many say that they don't know about them, that it's not well publicized. So, anything that you were to do on the tax incentive side would certainly have to be very well publicized at the same time.

Chairman NEAL. You cite a study showing that automatic enrollment in a 401(k) plan increased participation by new hires from 57 percent to 86 percent in 1 year. The increase was especially dramatic among young and low-income workers. I read recently that TSP has decided to auto-enroll in the same way.

Does it seem that the evidence from auto-401(k)'s show some need for an opt-out system, rather than opt-in? If we really want to induce more savings, is that the path we should travel?

Ms. BOVBJERG. Well, it's certainly encouraging that the initial information on auto-enrollment in 401(k)'s suggests that the idea that everyone had in creating this system appears to be right, that inertia can work for you in encouraging saving, rather than discouraging saving. That might be something that could work with workplace-based IRAs, as well.

Chairman NEAL. Okay. Mr. English?

Mr. ENGLISH. Thank you, Mr. Chairman. Mr. Reeder, may I ask specifically, one of the topics that we are exploring today is obviously the concept of the automatic IRA.

Can you generalize and share with us Treasury's view of this initiative and this device?

Mr. REEDER. Yes, Mr. English. The automatic enrollment, as has already been pointed out by other testimony, is a very effective tool in getting people who wouldn't ordinarily save to save. The Administration is committed to making auto-enrollment programs work.

The Pension Protection Act greatly improved the ability for employers to provide auto-enrollment. We believe that auto-enrollment, even in the context of an IRA, would greatly increase savings among employees, particularly low-income employees.

Mr. ENGLISH. Mr. Campbell, what is the view of the Department of Labor of the prospect of an automatic IRA device?

Mr. CAMPBELL. Well, as has been alluded to, in the context of 401(k)'s and other plans, automatic enrollment has proved to be very effective. The Department of Labor, as well as Treasury, have been very active in implementing regulations to facilitate that, and to make that known to employers, and advertise it. I think there is no reason that concept wouldn't work for IRAs, as well.

One distinction I think, though, is in the context of 401(k)'s, there is an employer who is selecting the providers of the invest-

ment options that workers are defaulted into when they don't give investment direction. Then, from the proposals I have seen so far, it is not clear to me how that issue would be addressed in some of the automatic IRA proposals.

Mr. ENGLISH. I guess, in a related point, in your view, studying the two proposals before the Committee, how would you anticipate automatic IRAs would be administered? Could they be administered without an excessive burden? Do you see any particular challenges in their Administration?

Mr. CAMPBELL Well, obviously, the goal would be to make a program like that not present an excessive burden.

I do think the issue I just mentioned is one of the crucial ones. In the context of a 401(k) or other plan, there is always someone out there who is responsible for the selection of investments, who is looking at the appropriateness, at the fees, and carrying out their fiduciary duties and assessing those factors in the interest of the workers.

If the intention in an automatic IRA is that the employer not be sponsoring a plan, it's not clear to me who then would fulfill that function, and how that would function in practice.

Mr. ENGLISH. Mr. Reeder, from the standpoint of the Treasury, do you see any special challenges in administering automatic IRAs?

Mr. Reeder. Other than the one Mr. Campbell pointed out, we don't see any special challenges.

Mr. ENGLISH. Thank you, Mr. Chairman.

Chairman NEAL. Thank you, Mr. English. The gentleman from Washington, Mr. McDermott, will inquire.

Mr. MCDERMOTT. Thank you, Mr. Chairman. I've been in Congress 20 years, so I fly back and forth on the same airline every Friday and Monday. I have gotten to know the United employees quite well.

I had a discussion with one of them the other day about the pension system that we have created for him by our laws, which allow companies to go into bankruptcy and strip out their pension benefits, and then throw people into the pension guaranty fund. This gentleman has worked for United Airlines as a flight attendant for 22½ years, and he is going to receive \$272 a month when he retires.

Now, I—what I am struggling with is how do we make a better system. It used to be that you went to work for a company like United, and you came out with a defined benefit—you knew what you were going to get when you got to your senior years, and you—we've changed all that by allowing the bankruptcy laws to be applied in the way they have.

How does this system of forced enrollment in a 401(k), how does that make it better for them? Explain how he will be guaranteed at the end of his working career, if he started 22 years ago putting money into this, how does he guarantee that he has a better deal now?

Mr. CAMPBELL Is that addressed to me, Sir?

Mr. MCDERMOTT. Any one of you.

Mr. CAMPBELL The—one of the virtues—obviously, all the different sorts of retirement plans and pension plans that are avail-

able have different strengths and weaknesses, which is one of, I believe, the benefits of our system, in that employers and workers are able to, together, select the plans that make the most sense for their particular situation.

One of the benefits of a 401(k) plan is portability. The contributions that have been made to the plan are the property of the worker from their inception, and can be rolled over and transferred from job to job. In an increasingly mobile work force, where fewer employees are choosing to work for the same employer for 20 or 30 years, that's a valuable benefit.

That is not at all to denigrate the importance of defined benefit plans, which is part of the reason the Administration urged Congress to pass the Pension Protection Act, to improve that system, improve its solvency, and protect the benefits of the workers that they've been promised.

Mr. MCDERMOTT. Is this system—education has always had the kind of—sort of you put your money in, and you can carry it from one university to another.

The question is how do you give the worker the ability to understand the costs in the system, and—the average person doesn't spend their life, if they're a professional, sitting around, figuring out what the 401(k) fees are, and where they're hidden, and all that sort of thing. What clarification do we need to make it possible for them to know what they're actually buying into, and what they're going to get?

Mr. CAMPBELL Well, the Labor Department currently has two regulations that we are in the processing of proposing that address both of those concerns.

The first is building on the investment advice provisions in the Pension Protection Act that make it easier for workers to get access to professional investment advice to help them make those decisions.

The second deals with disclosures to workers about both the fees, the past history, the performance, the nature of the investments in their plans in a very concise and useful way. So, that, rather than getting 20 or 30 pages of legal gobbledegook in a prospectus that is not read, the workers would instead get a very concise comparative document, or a chart that would let them get the basic information at a glance of what the options are in their plans, and make comparative judgements about them.

We anticipate issuing those proposed regulations in the near future. They are currently pending at the Office of Management and Budget under review, pursuant to the executive order.

Mr. MCDERMOTT. How do you guarantee the worker that some plan manager is not going to be doing what we've been seeing in Wall Street recently?

Mr. CAMPBELL Well, the Pension Protection Act provided a number of safeguards to ensure that the investment advice is impartial, and not tainted. Essentially, it either has to be provided on a level fee basis, in which the person providing the advice gets paid the same, regardless of the options the worker picks to invest in.

Alternatively, advice will be provided through an unbiased computer model that would have been certified not to give biased outcomes.

Mr. MCDERMOTT. But the worker—

Mr. CAMPBELL So, I that the congress has addressed that.

Mr. MCDERMOTT. But we just saw on television this last week people who, as the companies were going downhill at 100 miles an hour, were still recommending that people buy those stocks, right? How do you stop that? How do you protect the worker on United Airlines from that kind of investment scheme?

Mr. CAMPBELL Well, again, I think the intent that Congress has in passing the PPA, and that the Administration had in the investment advice provisions, is that workers will benefit from better information. There may well be analysts in the universe of picking stocks who advise this, that, or the other.

But the basic information about investing: the importance of diversification, the importance of investing in a way appropriate for your age, so that you're not holding 100 percent equities, or 80 percent employer stock when you're 10 years from retirement, that type of information will be extremely valuable to workers, and is the kind of information investment advice will make available.

Mr. MCDERMOTT. Thank you, Mr. Chairman.

Chairman NEAL. Thank you, Mr. McDermott. The gentleman from Connecticut, Mr. Larson, to inquire.

Mr. LARSON. Thank you, Mr. Chairman, and let me say from the outset I am an unabashed cosponsor of the Neal-English automatic IRA.

I have some questions and concerns, though, with respect to those that are not able to receive the benefit. I would like to ask all the panelists, but I will start with Mr. Reeder. This question has a couple of parts to it.

What, in your estimation, are the income classes for those who can benefit from IRAs? Who does this leave out? Is there a way, and what would be a way to—for government to help bridge this gap?

I believe that a saver's credit can be that bridge, but I am interested in what the panelists have to say. We will start with you, Mr. Reeder.

Mr. REEDER. As I pointed out in my testimony, the current tax preferences are dependant upon people's income, and whether or not they're covered by a employer-based retirement plan.

So, if they're not in an employer-based retirement plan, any taxpayer can gain the tax preference. I believe you're referring to people who aren't taxpayers.

Mr. LARSON. Exactly.

Mr. REEDER. Therefore, a tax preference is of no use to them.

Mr. LARSON. So, for example, people in the \$30,000 to \$50,000 range, can, in fact, because of—end up with no income tax liability, in essence, are the people most in need of savings, but in fact, it seems as though our system is geared toward providing those that don't need the savings to getting the savings.

Is there a way that you could see for government to bridge that gap, to help out the \$30,000 to \$50,000 person in this area?

Mr. REEDER. I think a lot of the people in that \$30,000 to \$50,000 gap are taxpayers, and they can avail themselves of the saver's credit, which is available. But I think you're referring to those people in that range that are not taxpayers. The bulk of

those folks are already getting a very large much larger portion of their income in retirement through social security.

So, there is a forced savings program in place already, in the form of social security for the——

Mr. LARSON. With the country at, for the first time since the Depression, at negative savings, should the government be involved in providing incentives to assist people in that range group?

I am all in favor of the automatic IRA. I think that that's a great step forward. But I think that there is still a gap.

Mr. Campbell, what does the Labor Department think?

Mr. CAMPBELL. One of the benefits of a payroll deduction IRA, for example, even if you ignore the question of whether there is a particular tax benefit to an individual, it is still a very convenient and easy way to save. One of the things I think studies have generally shown is that the easier it is to save, the less additional effort an individual has to make, the more likely they are to do so.

So, even if there is not a tax incentive for a lower income worker by virtue of a lack of tax liability, they still may be very effective in having these simplified programs as options——

Mr. LARSON. What about a government-incentivized saver's credit?

Mr. CAMPBELL. Well, I really do think I should probably defer to the Treasury Department on tax credit issues.

Mr. LARSON. Mr. Reeder, what about a government-incentivized saver's credit?

Mr. REEDER. Well, the saver's credit that exists, we're very much in favor of. We're a little bit concerned about making it refundable. We are constantly concerned about complexity of Administration and potential fraud that is available any time you have a refundable credit. But that is something that should be studied.

Mr. LARSON. Isn't it something like 59 million people that are eligible, but only about a fifth of them participate?

Mr. REEDER. I'm not particularly familiar with that particular ratio, but that sounds reasonable. That sounds like it's logical.

Mr. LARSON. Ms. Bovbjerg?

Ms. BOVBJERG. The saver credit—I'm aware that there are some statistics that it's not used to the extent that it could be. Making it refundable could entice more people into saving. I would like to see some analysis of how effective that would be, and how much it might cost, and I'm glad to hear that maybe that is being done.

I think, though, that, as Mr. Campbell says, the inertia of having something that is more automatic would be a huge factor for people. It would be interesting to see how much of the problem that might address.

Mr. LARSON. Mr. Reeder, you said that there were a lot of—you were concerned about the fraud, abuse, and administrative costs.

Could you amplify on that at all? I see my time is up, but——

Mr. REEDER. Well, I am not an expert in the Administration of all the credits at Treasury, but I do know that there are some issues, especially, for instance, with the earned income tax credit, which is refundable.

Mr. LARSON. Thank you, Mr. Chairman.

Chairman NEAL. Thank you, Mr. Larson. The gentlelady from Pennsylvania, Ms. Schwartz, is recognized to inquire.

Ms. SCHWARTZ. Thank you, Mr. Chairman. I too want to express my support, enthusiastic support, for Mr. Neal's legislation. I think the experience that we have seen already with opting out, rather than opting in—you've mentioned about the—getting people to—the inertia work in their direction, which is to encourage savings, is really important for all of us.

I think just—well, this afternoon, we will be passing a resolution to encourage Americans to save. Mr. Johnson and I did that. Having some tangible ability to do that, as we suggest in—with the IRAs, automatic IRAs, is really a good thing. So,—and I—so, like I say, I have been very supportive of doing more to encourage Americans to save, recognizing what we're up to.

One of my questions, and one that I wanted to raise with you, is something—is whether we could use the IRAs in a way that also addresses a slightly different problem.

I know there are some exceptions, or ways you can withdraw early from IRAs now, so it's a little different than what we've been talking about, but I wanted your opinion about something I've been thinking about, and that is that early retirees, basically those who are 59-and-a-half, may find themselves, particularly as we are moving ahead, unable to afford health insurance. It's really the largest group, as I understand it, of those Americans who don't have insurance, who are over 55, before they get Medicare.

I think that, particularly if they don't have health benefits that they can afford or extend beyond employment, if they choose to retire early, over 55, there is 5½-year potential gap of when they're going to find it very difficult to pay for health insurance, private health insurance.

So, my question is kind of an open-ended one, is what do you think about using potential—using tax law to allow people to withdraw from their IRA for the express purpose of paying for health insurance if they have chosen to retire early, for those five-and-a-half years? Can we make some exceptions in the ability to withdraw?

This is not withdrawing early, but to be able to use—say, not have to have them pay tax. So, it's treated sort of the same way that, if they were employed, they wouldn't have to pay taxes on their health benefit. This would sort of apply the same principle, but to the IRA, which they could then withdraw without penalty at age 59½.

So, sort of an open-ended question as to what you think about that. My thinking here is not only is health coverage a huge issue for many Americans, but particularly for those before Medicare in those early retirement years, but you know, it's also a way that people might want to say, "I don't want to save, because I'm afraid I might have certain kinds of expenses."

So, we have made some exceptions around education and health premiums if you're unemployed or buying a first home. So, given the concern we have about 47 million Americans, many of whom are in this age category, what do you think about that? I don't know if you haven't thought about it, but if you have, it's just sort of a concept?

Again, that would encourage people to think about using IRAs because they would know that they would be able to have the ability to use it for yet one more purpose.

Mr. REEDER. I don't know that any of us are in the position to give you a definitive answer, because this is one of the first times we have heard about it. But being from Treasury, I think I will start off the answers.

We, at Treasury, have long been concerned about the increasing erosion of retirement savings. When IRAs were first created, they were established solely for retirement. Now, not a year goes by when something doesn't come up to tap into those retirement savings, all of them good reasons, very valid reasons.

What you are proposing is a kind of a super-preference, because it would give to the distribution tax exemption, so it would be tax-free going in and tax-free going out. There is already a very limited area where that occurs, and that's with the HSAs. I think if you did that with IRAs, you may actually encourage people to tap their retirement savings who might not already be inclined to tap their retirement savings. They may have other assets that they could use to pay that insurance, but instead would use the retirement savings because it would be tax-free.

Also, a question whether or not it's equitable to give somebody who has an IRA that super-tax preference over somebody who doesn't have the IRA, who couldn't have the tax-free—

Ms. SCHWARTZ. But now with HSAs, for example, we get tax preferences for HSAs, and there are many people who don't have access to HSAs. You know, there are people who don't get health benefits through their employer. We give quite a bit of health preference—preferences to employers and employees who get benefits through their employer—through their workplace. If you're an individual, that's a different concern.

So, there are—there is a significance tax preference. Anyway I know it's a new idea—

Mr. REEDER. I understand.

Ms. SCHWARTZ [continuing]. But I just wanted to—I just was interested in whether that—it was something we might be able to consider as we consider encouraging people to save for retirement.

Again, some of the things that I think prevent people is that they worry about expenses coming up that they won't be able to handle that are pretty immediate. Even in this case, particularly someone who might have not started an IRA a long time ago—I mean, I don't think the 25-year-olds are thinking about this, but someone who is 45 might be thinking of this, who might say, "Well, I could do an IRA, but what happens to me, you know, when I'm 59½ and I'm going to retire early?"

So, if you have some thoughts about it—I think my time is up—but if you have some thoughts about it going forward, I certainly would appreciate maybe your thinking about that, or we could be in touch with you about this. Because again, these are both important issues for us, both retirement savings and, of course, health coverage for Americans, particularly those who are in early retirement, pre-Medicare.

So, I think with that, maybe this is a chat I should have with the Chairman at some point, as well. But I will. So, thank you very much.

Chairman NEAL. We thank the gentlelady. The gentleman from New York, Mr. Crowley, is recognized to inquire.

Mr. CROWLEY. Thank you, Mr. Chairman. If I could, for Ms. Bovbjerg as well as Mr. Reeder, my question pertains to the benefits in the Tax Code for encouraging retirement savings. The government estimates show that the Treasury—\$110 billion in revenue in an effort to encourage savings. That was in 2007. But the data shows that those who are receiving—who are saving in IRAs are—tend to be better educated and higher wage earners than the average American.

The question I have—and not necessarily in a way to disparage the system, it's just more a sense of feel from you all—do you think that these tax subsidies are encouraging savings, or are they simply rewarding people for actions that they would otherwise—they would take normally anyway, in terms of savings?

If you think these benefits are helping to encourage savings, how can we expand these benefits to capture more Americans in the system?

Ms. BOVBJERG. Well, you're bringing up the flip side of the point that someone raised earlier, which is a tax incentive is a bigger incentive for someone who is in a much higher tax bracket than—

Mr. CROWLEY. Right.

Ms. BOVBJERG [continuing]. It is for someone who is not paying very much tax. This is an issue that, actually, comes up all the time in the pension area, and it is something that Ways and Means has asked GAO to look at, the distributional effects of the tax preferences and pensions.

Mr. CROWLEY. Mr. Reeder?

Mr. REEDER. I think the behavioral economists—of which I am definitely not—would agree that the incentives do produce new savings. But I also think they would agree that some of the savings is savings that would occur anyway. So I think the answer is, a little bit of both.

Mr. Larson was focusing largely on how to refocus that tax preference so that it does create retirement savings that wouldn't have ordinarily occurred. I don't have the silver bullet for that answer, and there may be some things you can't do with the Tax Code. But I think most people here think you can do most anything with the Tax Code.

[Laughter.]

Mr. CROWLEY. Ms. Bovbjerg, in your report you mention that there are some barriers that exist that discourage employers from offering payroll deduction IRAs, and you include in that lack of flexibility, cost to employers, limited incentives to employers to offer the plans, and generally a lack of awareness.

Could you walk us through how a small business—one in the range of 12 or so workers—would try to access a payroll deduction IRA for their employees, and do that in a real-world context, as well as perceived barriers, and suggest ways that we can help break down those barriers?

Ms. BOVBJERG. I am quite sure I could not do justice to the plight of the small businessperson in managing such a thing.

But the first thing is you would have to know about it. Apparently, many of them don't know that this is an option. They have fears that if they do offer this to their employees, and they identify a provider and then tell the employees about it, that suddenly they will be a fiduciary under ERISA, that they will be a plan sponsor.

Now, we know that that is not the case, that it is not true, Labor has put safe harbor guidance out there. But if I'm the small businessowner, I have to be able to understand that guidance. It probably would also help if my employees asked me if I would do it.

But I think that it can represent a burden to people to find out about these things. If they do their payroll by hand, it's another thing that they have to deal with, to employ the payroll deduction and send it off to whoever is holding the IRA. It could be burdensome.

But there are a lot of small businesses who do have electronic payroll. There are probably not as many for employers with fewer than 12 employees than for those with 50. But there are those with electronic payroll who still are not doing this.

So, when we made recommendations to Labor and IRS, we were really thinking it's not that Labor's doing something poorly, or doing something bad, it's just that it's pretty clear when you go out there that Labor is not doing enough to incentivize these employers.

Mr. CROWLEY. Thank you. Mr. Reeder, finally, the saver's credit that was created in 2001 was billed as being a tool to help taxpayers earning less than \$50,000—a credit for depositing money in their 401(k) accounts.

How many people have enrolled in that program? My concern is that it does not appear to be working as intended for several reasons. One, low-income folks don't have the means to save as others do, simply because they're living paycheck-to-paycheck.

Secondly, this is a non-refundable tax credit. Many of these people have very small, if any, income tax liability.

Does the Administration think we should expand this credit to be a refundable credit?

Mr. REEDER. I am not in a position to say that we are for or against making it refundable, but I have expressed concerns about administratability, and it would have to be evaluated in terms of the revenue involved in the entire portion of the bill.

But I agree with you, that it doesn't encourage everyone to save. There are some people who just do not think they have the means to save.

Mr. CROWLEY. How many actually—if you could, Mr. Chairman—if I could just further inquire—how many people have actually enrolled in this program?

Mr. REEDER. It's about 5.3 million people.

Mr. CROWLEY. Generally, of what age are those individuals?

Mr. REEDER. I don't have the age breakdown with me. I don't even have a speculation. But I could definitely provide that data. I think we have an age breakdown, I'm not positive.

Mr. CROWLEY. We would be interested in that, I think, how many people are borrowing from their parents in order to make access to that enrollment. So, I would appreciate that, thank you. Thank you, Mr. Chairman.

Chairman NEAL. We thank the gentleman, and the gentleman from Wisconsin, Mr. Kind, to inquire.

Mr. KIND. Thank you, Mr. Chairman. Thank you, again, for holding this very important hearing today. I thank the panelists for your testimony.

Mr. Campbell, real quick, Mr. Hulshof and I certainly would appreciate any Administration feedback that you might have with the SAVE Act that we had previously introduced and was testifying about today.

Ms. Bovbjerg, we appreciate the GAO update of the study and report that you just released this month on increasing savings opportunities for more employees.

Perhaps I should have read it a little more closely, but were you offering some recommendations—and you testified previously about the need to do more education outreach with small businesses throughout the country, about the availability of what already exists, but did GAO offer any recommendations, or policy guidelines on how we can best accomplish that at all?

Ms. BOVBJERG. It's difficult for Labor, because they are already doing a lot. We felt that, for example, in the guidance they could be more specific about what would make you into a title 1 ERISA employer, and what does not, you know, what exactly constitutes the safe harbor.

It's difficult to reach out when you don't always know who is eligible to do this. I mean, one of the frustrations that we found is there are no data on payroll deduction IRAs. We thought that anything that could be done to learn more about these, learn more about what it costs small employers to do it, you know, what are really the fears out there, and how we can learn more about how many are out there. We thought that the Bureau of Labor Statistics, for example, could add some questions to their national compensation survey that would help.

I mean, these are also things that could be done in the context of some of the policy changes that have been suggested here today, in your bill, or in the Neal-English bill. Oversight, as well, would be important. Those were the recommendations that we made.

Mr. KIND. Right. Well, the more that we've researched the topic, too, I think there is a very real concern about any fiduciary obligation that small businessowners would have by offering these types of plans. We were trying to clarify that more, and make it more explicit in the legislation, that—so that's not an additional burden that might prevent them from offering these plans for their employees.

But you know, staying with you—and, if Mr. Campbell and Mr. Reeder, if you want to chime in on this, as well—but we were trying to thread the needle a little bit as far as the automatic enrollment in IRA under our legislation. We allow the automatic enrollment, but we still allow the discretion of the small businessowner, whether they want to participate in the automatic sign-up, or the automatic—therefore, not mandating it upon them.

Because the concern, obviously, that we share is that if you have too many strict mandates on small businesses, they're just going to walk away from it anyway, and not offer it to their employees.

Does that seem to you to strike the right balance, having an automatic enrollment, but still leaving it up to the discretion of the small business employer, of whether or not to have that feature applied at the plan that they're offering?

Ms. BOVBJERG. Well, you would have to make sure that people know that this is out there. I think we would have to do more, because otherwise it's not really clear that you would have that many employers participating.

On the other hand, it's difficult to measure any increase that might result, since we don't know how many are out there now.

Mr. KIND. Right. Mr. Campbell, any thoughts?

Mr. CAMPBELL. Well, I would say, conceptually, that is very similar to what Congress did in the PPA with respect to automatic enrollment in 401(k) plans. It's now very clear that this is a feature that plans may adopt, but it's not required that plans adopt it.

I guess my concern, as I had expressed earlier, is the question of, when it comes to automatic enrollment: who is making decisions about the appropriateness of the default investments when workers aren't providing elections, who is assessing the reasonableness of those fees, is the employer a fiduciary for those purposes or not? That's a question that didn't arise in the 401(k) context, because it's very clear they are fiduciaries, and do have that responsibility.

Mr. KIND. All right. That's a good point. Mr. Reeder?

Mr. REEDER. Bearing that particular problem in mind, I think your approach does strike the right balance. We too are concerned about the mandates on small employers, and the likelihood of that affecting other benefits that employers may offer, and also whether or not the employer is willing to adopt a more flexible 401(k) plan. If you force them into an IRA, it may detract from their desire to go into a more sophisticated plan.

Mr. KIND. Right. Thank you all. Thank you, Mr. Chairman.

Chairman NEAL. I thank the gentleman. The gentleman from North Dakota, Mr. Pomeroy, is recognized to inquire.

Mr. POMEROY. Thank you, Mr. Chairman. I want to begin by commending you on this hearing. I think the hearing is very important in a couple of respects.

First, it clearly establishes that Ways and Means is going to be vigorous in its assertion of jurisdiction relative to retirement plans. They are rooted in the Tax Code, this is squarely in our ballpark. We don't intend to defer to another Committee. This is what we're going to do. Thank you for your leadership as Subcommittee Chairman.

Secondly, I really—I think that the panel has been terrific, and I am very delighted with the engaged participation of the Members.

As we look at what's ahead of us as a country, getting people prepared for lifelong income in retirement, and the retirement savings dimension of that puzzle, is extremely important. I think we're probably a little belated in really putting this in central focus, but it's pretty clear from this morning that's exactly where it is now, and that's terrific. Better late than never, and I think this is terrific.

I am all for the goal of improving savings. Workplace-based savings vehicles have been the most effective means of promoting savings for retirement, in my view. In North Dakota, we've got about 4 out of 10 workers that have that opportunity. So, ways that we expand it? I'm very interested in looking at all possibilities.

I do share the concern that Treasury represented, that we don't want to advance something by way of a default IRA administered at the employer level, thinking we're reaching the roughly half nationally that don't have workplace savings, only to find that we're somehow eroding 401(k) sponsorship by plans. I think we've got to pay very close attention to the interplay of trying to extend reach without somehow disincenting what we have already achieved in the voluntary employer participation. So, we will have to be careful on that one.

I want to now turn to issues of retirement savings, and things that we're hearing. One of the things we're hearing is—I remember last decade, people my age, the Baby Boomers, talking about early retirement, suddenly retiring in the fifties, pretty broad-spread aspiration. 401(k) balances rising appreciably, everyone pretty happy.

How that has changed. We now see that basically the Dow, at the beginning of the decade, was \$10,500 to—now it's about \$11,800, a 10 percent increase over the last 8 years. The account balances haven't grown like people thought. Wages have stagnated, prices have increased. People have actually gone into their IRAs—their 401(k)s, borrowed against them.

In any event, there is much less anticipation of what's happening there, which means, I think, there is now a widely spread view that we're going to be working a few years longer than we might have wanted or thought we would have to.

The data from GAO, Ms. Bovbjerg, has been particularly telling, in terms of asset accumulation, especially focused on the baby boom cohort. I don't know if you're familiar, off the top, with it or not, but I will quote some of the findings released a year ago in a GAO study.

The—of \$7.6 trillion in financial assets held by baby boomers, the top 50 percent owned 97 percent; the bottom 50 percent owned 3 percent. It's staggering. The bottom 50 percent of baby boomers owned 3 percent of the wealth held across that cohort, with about a third having no wealth whatsoever. I think that this speaks to, in part, earnings capability—or earnings levels that really are not providing the opportunity to save.

I have been very pleased with the saver's credit enhancing the incentive to modest earning levels. While I think it would be better extended on a refundable basis, the reality is if your income is so low there is no tax liability, the opportunity we're going to enlist people even with the saver's credit extended on a refundable basis, in my opinion, is less than people might expect.

What does—Barbara, based on your familiarity with these studies, do you have observations about wealth distribution across the cohort that you could expand upon?

Ms. BOVBJERG. Well, I know the report that you mention. It's one that uses the term "Baby Boom Generation" in the title, I think, and we were asked to look at the issue of whether, when boomers retired—because it's such a large generation, and each

year the birth cohort grew so quickly—when boomers retired, would there be a market meltdown in the stock market.

The short answer in this report was, “Good news: No, there won’t be a market meltdown, because retiree behavior is such that people continue to buy and sell stock in their retirement, they wouldn’t just sell it all at once.”

The bad news was that hardly anyone in the boomer generation had assets, and the figures that you mentioned were very surprising to us. We found that there was a significant portion of that cohort whose greatest financial asset was their vehicle. Boomers are not—speaking as one, I can say this—are not young people any more. I’m sorry.

Ms. TUBBS JONES. Speak for yourself.

Ms. BOVBJERG. Well, I’m on that front edge.

Chairman NEAL. Let’s not try that again.

[Laughter.]

Ms. BOVBJERG. But the younger boomers were born in 1964. They’re already in their forties. They needed, in this retirement income world that we’re facing, they really needed to have started saving before this, and they have a lot of catching up to do.

We did another report on defined contribution plans that included IRAs, by the way, because we had difficulty separating them from 401(k)’s, and we found that the average balances, even if you project out into the future, into the 1991 birth cohort, were not really going to be substantial. There will be people who will have significant balances, who will certainly have the resources for a secure retirement. But there will be a significant percentage who will not have anything from defined contribution plans. They’re going to essentially be living on Social Security.

So, the concern about how to help people save and how to help assure a secure retirement for people, particularly in the lower earner categories, is really urgent and crucial.

Mr. POMEROY. Thank you. Thank you, Mr. Chairman.

Chairman NEAL. I thank the gentleman. The gentlelady from Ohio.

Ms. TUBBS JONES. Thank you, Mr. Chairman.

Chairman NEAL. You’re recognized to inquire.

Ms. TUBBS JONES. Ranking Member. I am in the baby boomer session. I’m a 49’er and I think I’m still young and active. We’re still in this, and we’re going to be in it for a while.

But all kidding aside, this is an area that is very important to me. I don’t serve on this Subcommittee any more. I used to serve on the Subcommittee, and moved on to health Subcommittee. But retirement security is a big deal for me, and I think that I want to celebrate my colleagues for offering this proposal. I have not signed on yet, but I am taking a close look at it.

There are lots of things that we have to do. Just as we are in the midst of a real issue in the housing foreclosure area because people were not well educated in the process—most of them, there are some who did it, not knowing what the possible consequences are. There are people in America who are still not well educated on retirement security.

I want to contemplate that we should determine how our Committee could give some incentives to young folks to start very early

in the retirement security piece, even if it were part of—and I'm jumping into the education and the workforce Committee for a moment, but required course work for young people to graduate from high school, to require them to understand this process. But in the interim, while the people who are already out of high school like us, that just graduated about 10 years ago, we need to work on incentivizing them, as well as incentivizing employers and others to encourage retirement security.

See, when I speak, the bells go off, things start ringing, and everything. So, I'm going to stop, just for a moment, for the bells to stop ringing. They stopped. This is my pager going off on me.

But what I am curious about—and when I was outside in the anteroom, I heard someone speaking about United Airlines employees. Who was that? Anybody?

Mr. POMEROY. Mr. McDermott.

Ms. TUBBS JONES. Oh, Mr. McDermott. The reason it's of importance to me is my father was a United Airlines employee, my brother-in-law and my sister were all United Airlines employees, and I watched the concern that happened with that company, as well as with all the steel companies and all the rest, about how do we handle that retirement issue.

But as we're talking about IRAs, we tend to be now talking about people who choose to invest or put money into an individual retirement account. I think that we're going to have to spend some time really, really incentivizing employers to have this discussion, just like we incentivize them to have money to do training for their workers. Small manufacturing shops have the opportunity to get money to train their workers. We ought to figure out how we can include the whole discussion about financial literacy, as well as investment for the future.

I really don't have a lot of questions. Since the bells are going off, I know people are looking at me, "All right, shut up, Stephanie, we've got to move on," but I just come to this Committee—I know you're not saying that, Earl, you're my good friend, okay—but I come to the Committee to express my concern on this issue, to celebrate the work of my colleagues, and to let you know that, from my perspective, from my office, I'm ready to go to work to help workers across this country plan for retirement.

One of the things that I have done in a totally different area was to incentivize workers who receive lump sum benefits to purchase an annuity so that that money lasts over time. Because we all know when you get a lump sum, it seems like a whole lot of money that day. But if you spend it off, over time there is none left when you retire.

I thank you, Mr. Chairman, for giving me a chance to sit in with you guys today and be a part. Thank you very much.

Chairman NEAL. Thank the gentlelady for her thoughtful commentary. Let me thank our panelists for their very thoughtful testimony today, as well.

I would like to advise the third panel that we now have three votes on the House floor. So, the Committee would stand in recess for approximately 20 minutes. At that moment in time we would reconvene. I want to thank the panelists, again, for their help.

[Recess.]

Chairman NEAL. We thank the panelists as we reconvene. I would like to begin by recognizing Mr. Estrada.

STATEMENT OF LEOBARDO ESTRADA, PH.D., PROFESSOR OF URBAN PLANNING, UNIVERSITY OF CALIFORNIA, ON BEHALF OF AARP

Mr. ESTRADA. Thank you very much, Mr. Chairman. My name is Leo Estrada, and I am a member of the board of directors of AARP, and I am here today to testify on their behalf and our 40 million members who are representative of the nation, as a whole. Just like the rest of the nation, they are feeling the impact of the high cost of food and energy, and are being forced to make difficult economic decisions with dire long-term consequences.

As increased costs continue, a quarter of all baby boomers are pulling money out of their retirement savings early to pay for everyday expenses, like health care and food. For many segments of the population, the news is even worse. A third of Hispanics are no longer saving for retirement, and 26 percent are prematurely raiding their nest eggs to pay for everyday needs. Half of all women have no pensions, and 44.3 percent of African Americans aged 65 and older receive all of their income from Social Security payments, alone.

Certainly this economy is hitting us all, and efforts like the recently passed stimulus checks are helpful. But we must look beyond the near term. We are thankful for the Committee's vision in examining long-term solutions to the financial crisis our Nation currently faces.

The idea that retirement finances consist of a pension, personal savings, and social security is dying out. Defined pensions are fewer and further between, and personal savings very often consists of equity in a home. AARP believes that all workers need access to a retirement plan, in addition to social security. Yet this is a far cry from where we are today.

In fact, millions of Americans go to work every day and never get the chance to save for their retirement. Many are our members, and many are children and grandchildren of our members. According to the IRS, an estimated 79 million U.S. workers are not participating in a retirement plan in their workplace. Many of these workers are employed by businesses that do not even offer a retirement plan.

The lack of access to a workplace-based retirement savings plan is particularly acute for employees of small businesses. Only 44 percent of the employees who work in firms with less than 100 employees have access to an employee retirement plan. Employers currently can make payroll deduction IRAs available to their workers, but clearly, very few do.

The data also shows that about 10 percent of people eligible to contribute to an IRA actually make contributions in any given year. As a result, a significant segment of the U.S. work force does not save systematically for retirement.

Mr. Chairman, we must address this lack of workplace savings option now, or future retirees will face greater economic instability, and put more strain on already taxed government programs.

One innovative common-sense idea that can help combat retirement insecurity is the automatic IRA. It would make a huge difference to over 50 million workers and their families. We are very pleased, Mr. Chairman, that you and the ranking Member of the Subcommittee, Mr. English, have introduced H.R. 2167, The Automatic IRA Act of 2007. We also appreciate the cosponsorship of other Subcommittee Members. The bipartisan support for this initiative is a positive development for our future retirement security.

Your legislation proposes an ambitious but practical mechanism to expand retirement savings for millions of workers. This approach involves no employer contributions, no employer compliance with a qualified plan—ERISA requirements, and no employer liability or responsibility for selecting a provider or opening IRAs for employees.

AARP has been reaching out to small businessowners to find out how they view this legislation for some time, and the response has been very positive. Small businessowners recognize the need to help their employees save for retirement.

For example, Mr. Gary Kousan of Allentown, Pennsylvania reflects the views of many small businessowners. When we asked him to comment on why it was important to help his 15 employees save and plan for a secure retirement, he said—and I quote—“Because I didn’t do it myself. My son works for me now, and if I had started saving when I was his age, I would be in a much better position. I understand how important it is,” he said, “the auto-IRA is so convenient. As long as my employees can opt out, it’s a great system. It is difficult in a business this size to offer any significant perks, and auto-IRA allows me to offer my employees something.”

According to the AARP survey, 84 percent of our members and 76 percent of Americans age 50 and older would like to have a workplace IRA.

I will leave you with this final statistic. In a recent study on how the current economic downturn is affecting people, 74 percent said their elected officials are not doing enough to help those being squeezed by the current economy.

We have listened to the people who are struggling to have a secure retirement. Their problem is clear, and the automatic IRA is a first step to the solution.

In conclusion, automatic IRAs create the potential help for finally filling the gaps in retirement savings coverage in the United States. Automatic IRAs will be particularly beneficial to many low-wage workers who do not currently have access to an employer-sponsored retirement plan.

Thank you, Mr. Chairman, and Members of the Subcommittee. I would be happy to answer any questions you might have.

[The prepared statement of Mr. Estrada follows:]



**TESTIMONY BEFORE THE
HOUSE COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON SELECT REVENUE MEASURE
ON
THE ROLE OF INDIVIDUAL RETIREMENT ACCOUNTS
IN OUR RETIREMENT SYSTEM**

June 26, 2008

WASHINGTON, D.C.

**WITNESS: Dr. Leobardo Estrada
Member, AARP Board of Directors**

**For further information
Contact: Frank Toohey
Government Relations and Advocacy
(202) 434-3764**

Mr. Chairman and members of the Subcommittee, My name is Leobardo Estrada, I am a member of the AARP Board of Directors. I am here today to testify on behalf of our more than 39 million members, AARP is the largest organization representing the interests of Americans age 50 and older and their families. About half of AARP members are working either full-time or part-time.

Thank you for convening this hearing on the role of individual retirement accounts in our retirement system. We appreciate this opportunity to urge support for legislation that would significantly expand the use of the Individual Retirement Accounts (IRA) by extending payroll deduction coverage to the millions of workers currently unable to save for retirement through the workplace.

AARP thanks you Mr. Chairman and the ranking minority member of the Subcommittee, Mr. English, for introducing H.R. 2167, the Automatic IRA Act of 2007. We also appreciate the support of the other members of the Subcommittee on Select Revenue Measures who have cosponsored the Automatic IRA Act of 2007, including Reps. Blumenauer, Emanuel, Schwartz, Larson, and McDermott.

Auto IRA and Its Importance

The Automatic IRA is an innovative, bipartisan, common sense idea that can help the millions of workers who do not have an employer sponsored retirement income vehicle to save for retirement. The Automatic IRA Act of 2007 proposes a simple but practical mechanism to expand dramatically retirement savings for workers who are not currently offered an employer-provided retirement plan. The bill would require employers to offer employees the opportunity to save for retirement through the payroll process.

The automatic IRA would feature direct payroll deposits to a low-cost, diversified individual retirement account. Most employees not covered by an employer-sponsored retirement plan would be offered the opportunity to save through the powerful mechanism of regular payroll deposits that continue automatically (an opportunity now limited mostly to 401(k) plan eligible workers). Employees would choose whether or not to take advantage of this simple effective savings vehicle.

Employers with 10 or more employees that have been in business for at least two years but that do not sponsor any plan for their employees would be called upon to offer employees this payroll-deduction saving option. These employers would receive a temporary tax credit for simply serving as a conduit for saving, by making regular payroll deposit available to their employees.

Employers making direct deposit or payroll deduction available would be protected from potential fiduciary liability and from having to choose an IRA or arranging default investments. Instead, diversified default investments and a handful of standard, low-cost investment alternatives would be specified by statute and regulation. Payroll deduction contributions would be transferred, at the employer's option, to a central repository, which would remit them to IRAs designated by employees or, absent employee designation, to a default collective retirement account.

This approach involves no employer contributions, no employer compliance with qualified plan or ERISA requirements, and, as noted, no employer liability or responsibility for selecting investments or an IRA provider, or for opening IRAs for employees. By capitalizing on the existing IRA system, the legislation also steers clear of any adverse impact on employer-sponsored plans or on the incentives designed to encourage firms to adopt new plans. In fact, this proposal could draw some small employers into the private pension system.

Auto IRAs appeal to workers and employers alike

According to research and surveys conducted by AARP, 84 percent of AARP members and 76 percent of Americans age 50 and over would like to have a workplace IRA as an option to help people save for retirement. AARP has been reaching out to small business owners and asking them how they view this legislation. The response has been very positive. Small business owners recognize the need to help their employees save for retirement. Mr. Gary Kousan of Allentown, PA, reflects the views of many small business owners. When AARP asked him to comment on why it was important to help his 15 employees save and plan for a secure retirement, he said:

“Because I didn’t do it myself. My son works for me now and if I had started saving when I was his age, I would be in a much better position now. I understand how important it is. The Auto IRA is so convenient. As long as my employees can opt out, it’s a great system. It’s difficult in a business this size to offer any significant perks. Health insurance is so expensive, gas is almost \$5 a gallon. Auto IRA allows me to offer my employees something.”

In January 2008, Prudential released a report, “Saving for Retirement At Work: Employee and Business Reactions to an Automatic IRA Concept,” that surveyed 214 businesses (with 10 or more employees, in business 2 or more years, with no current retirement plan) and found that 8 out of 10 businesses surveyed support the adoption of the Auto-IRA concept. Specifically, businesses perceive strong program value to both themselves and to their employees:

- 80% of the employers appreciate the lower level of administration and believe the proposal is well-positioned to overcome prior barriers of excessive administration cost
- 89% of employers believe the Auto-IRA proposal will help their employees save. 77% think it’s affordable for their employees and 77% say it will be easy for employees to understand

The Uncovered

AARP believes that it is important for this committee and others to understand more about the uncovered population. According to the Internal Revenue Service, an estimated 79 million U.S. workers are not participating in a retirement plan in their workplace.^[1] Many of these workers are employed by businesses that do not offer a retirement plan. For those who work for an employer with a retirement plan, many may not be eligible to participate in that plan.

^[1] Calculations based on data found in Bryant, Victoria, “Accumulation and Distribution of Individual Retirement Arrangements, 2004,” *Statistics of Income Bulletin*, Spring 2008, 90-101. The IRS estimates that 145 million workers file a tax return, but only 66 million make contributions to qualified workplace retirement plans, as reported on their Forms W-2. The 145 million workers includes only those eligible to contribute to an IRA; i.e., those under age 70 and a half with earned income, and older taxpayers with earned income and modified AGI under the Roth IRA limit.

The lack of access to a workplace-based retirement savings plan is particularly acute for employees of small businesses. Only 45 percent of employees of small employers (those with less than 100 employees) have access to an employer retirement plan.^[2]

While Individual Retirement Accounts are generally available to these workers as an alternative to a workplace-based retirement savings program, the data show that a very small percentage (about 10 percent) of people eligible to contribute to an IRA actually make contributions in any given year.^[3] As a result, a significant segment of the U.S. workforce does not save systematically for retirement.

Research indicates that most employees favor saving automatically through regular payroll deductions — this is especially true for more moderate income persons. Studies have also shown that automatic enrollment programs provide a way of improving retirement savings by using the so-called “power of inertia” to change non-savers into savers. Automatic enrollment requires workers to elect “not” to participate in a retirement savings program, rather than requiring them to take specific action to participate. Participation rates in employer retirement savings plans are significantly higher when automatic enrollment is utilized.

Automatic IRAs are designed to fill the void for private sector workers who do not have access to a workplace-based retirement savings program.^[4] Automatic IRAs would make payroll deduction IRAs available to all workers who do not have access to an employer retirement plan. In addition, Automatic IRAs would utilize automatic enrollment to ensure that a greater number of workers actually participate in the program.

The Workers Most Likely to Participate in Automatic IRAs

Since the 1980s, the percentage of private sector workers participating in employer-sponsored retirement plans has remained fairly stable, hovering around 50 percent.^[5] Internal Revenue Service (IRS) tabulations of tax return data suggest that an estimated 79 million U.S. workers out of 145 million workers are not participating in a retirement plan in their workplace. Many of these workers do not participate because they do not have access to a plan in their workplace. Other workers may have access, but are either ineligible to participate in the plan or choose not to participate.

^[2] “National Compensation Survey: Employee Benefits in Private Industry in the United States, 2007.” U.S. Department of Labor, U.S. Bureau of Labor Statistics. Summary 07-05, August 2007.

^[3] Bryant, *supra*.

^[4] Employers currently can make payroll deduction IRAs available to their workers. The Congressional Budget Office estimates that approximately 7 percent of workers have access to this feature. See Congressional Budget Office, “Utilization of Tax Incentives for Retirement Saving: Update to 2003,” *Background Paper* (Washington, D.C., March 2007).

^[5] *National Compensation Survey: Employee Benefits in Private Industry in the United States, March 2007*, Summary 07-05. U.S. Department of Labor, U.S. Bureau of Labor Statistics, August 2007. Paid employment consists of full and part-time employees, including salaried officers and executives of corporations, who were on the payroll in the pay period including March 12. Included are employees on sick leave, holidays, and vacations; not included are proprietors, self-employed, unpaid family or volunteer workers, farm workers, and domestic workers. <http://www.bls.gov/news.release/sp/elsm0006.pdf>. This survey is a survey of establishments. The survey data represents approximately 108 million private industry workers, 83 million of whom are full-time workers. For purposes of this survey, agriculture, private households, aircraft manufacturing, State and local governments, and the Federal government are excluded.

Of the 79 million taxpayers who do not have access or choose not to participate in an employer retirement plan, not all will be eligible to participate in Automatic IRAs. Very small employers, new employers, government employers and churches would not be required to offer an Automatic IRA. In addition, employers could elect to exclude employees under age 18, nonresident aliens, and certain other employees from eligibility for Automatic IRAs. Thus, it is estimated that approximately 50.2 million workers would be *eligible* to participate in an Automatic IRA program through their employers, in 2009.^[6] In addition, the total number of workers who are eligible for Automatic IRAs at some point during their working career is likely to be much higher because of job mobility.

Demographic Characteristics of Eligible Automatic IRA Savers

Because the percentage of private sector workers covered by an employer-sponsored retirement plans has remained around 50 percent since the 1980s, this suggests that the converse – the percentage of workers *not covered* by an employer-sponsored retirement plan – also has remained stable. The characteristics of the uncovered workforce have also remained fairly stable, as well.

The Government Accountability Office (GAO) released one of the few studies to focus on workers not covered by an employer-sponsored retirement plan.^[7] They identified the most common characteristics of these workers during the ten-year period from 1988 to 1998. GAO found that about 85 percent of uncovered workers shared one or more characteristics. Generally, they were more likely to have lower incomes (81 percent); worked part-time or part-year (79 percent); worked for a small employer (82 percent); or were younger than 30 years of age (76 percent).

The characteristics identified by the GAO remain prevalent today among the uncovered workforce as documented by the Federal Reserve Board Survey of Consumer Finance (SCF) and Bureau of Labor Statistics, National Compensation Survey (NCS). Analysis of the 2004 SCF by the Congressional Research Service and the AARP Public Policy Institute confirms the GAO finding that lower income, part-time work status, employer size, and age were important determinants of workplace retirement savings coverage.^[8] The 2004 data also indicate that white workers were more likely than others to have coverage. For example, 56 percent of white workers but only 30 percent of Hispanic and Latino workers had coverage at their current or a previous job, and 68 percent of white workers but only 33 percent of Hispanic and Latino workers had either pension coverage through employment or an IRA or Keogh account. In addition, the SCF suggests that full-time workers were 2.5 times more likely than their part-time counterparts to have workplace retirement coverage.

The approximately 50.2 million workers who will be *eligible* to participate in an Automatic IRA program (shown in Table 1 and Graph 1, below) are likely to share the characteristics of

^[6] See Schmitt, Mary M. and Judy A. Xanthopoulos, *supra*, for derivation of estimate for 2007. Current estimates updated using most recently published SOI tables for tax year 2005. As the number of workers increases over time, the number of eligible participants will also increase.

^[7] U.S. General Accountability Office, GAO/HEHS-00-131, "Characteristics of Person in the Labor Force Without Pension Coverage," Report to Congressional Requesters, August 2000.

^[8] Patrick Parcell, "Retirement Savings and Household Wealth: Trends from 2001 to 2004," CRS Report for Congress, RL30922, updated May 22, 2006.

the workforce described in these studies. The Automatic IRA proposal will encourage many of those not covered by an employer-sponsored retirement plan to begin saving for their retirement. The importance of introducing so many workers to retirement savings cannot be underestimated, since both the GAO and SCF studies indicate that individuals without retirement assets are less likely to have other forms of financial assets.^[9]

Estimating Eligible Automatic IRA Savers by Income Class

Automatic IRAs will likely become the primary source of retirement savings for many lower-income workers. Estimates indicate that 50 percent of workers eligible for Automatic IRAs will have adjusted gross income of no more than \$20,000 per year. The estimated income distribution and estimated average annual contribution by income level of individual taxpayers eligible for Automatic IRAs are presented in Table 1 and Graph 1, below.

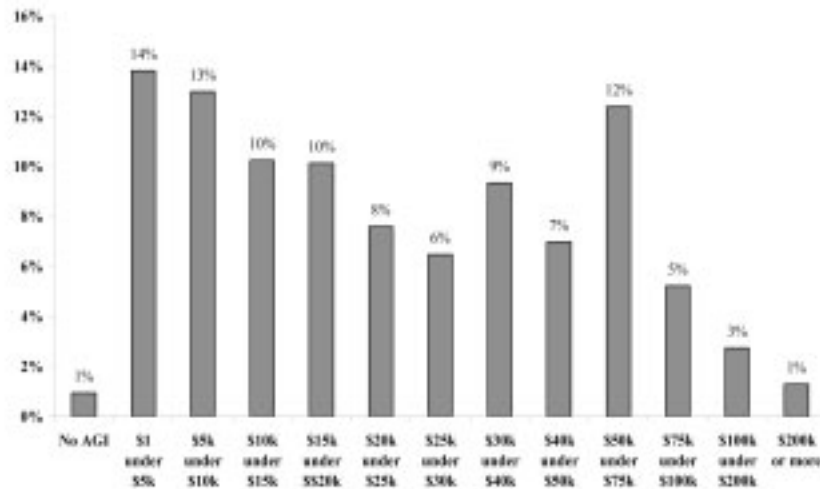
The estimated average Automatic IRA contribution reflects an assumed default contribution rate of 3 percent of the average wages for an individual in a given income class. This estimate assumes that most employers would provide the default deferral rate, at least in the short run after Automatic IRAs are first enacted. This rate is consistent with the default deferral rate for automatic enrollment in 401(k) plans.

^[9] Brian K. Bucks, Arthur B. Kennickell and Kevin B. Moore, "Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finance," Federal Reserve Board, Survey of Consumer Finance, 2006.

Table 1 – Estimated Distribution of Taxpayers <i>Eligible</i> for Automatic IRAs in 2009 and Estimated Average Contributions Source: Estimates based on published IRS SOI Tables		
Adjusted Gross Income	Estimated Number of Taxpayers (in thousands)	Estimated Annual Contribution to Automatic IRA for an individual (average dollars, per person, per year)
No AGI	470	\$ - 0 -
\$1 under \$5,000	6,940	\$ 75
\$5,000 under \$10,000	6,520	\$ 225
\$10,000 under \$15,000	5,140	\$ 375
\$15,000 under \$20,000	5,080	\$ 525
\$20,000 under \$25,000	3,810	\$ 675
\$25,000 under \$30,000	3,250	\$ 825
\$30,000 under \$40,000	4,690	\$ 1,050
\$40,000 under \$50,000	3,500	\$ 1,350
\$50,000 under \$75,000	6,210	\$ 1,875
\$75,000 under \$100,000	2,620	\$ 2,625
\$100,000 under \$200,000	1,370	\$ 3,000
\$200,000 under \$500,000	450	\$ 3,000
\$500,000 under \$1,000,000	120	\$ 3,000
\$1,000,000 or more	80	\$ 3,000
Total Eligible for Automatic IRAs (Not Participants)	50,250	

The average contributions to Automatic IRAs are likely to increase as employers utilize automatic increases in the contribution rates to increase retirement savings. Studies have shown that employer 401(k) plans with automatic increases in contribution rates improve the rate of retirement savings over time.

Graph 1 Automatic IRA, Estimated Eligible Taxpayers by Adjusted Gross Income



Source: Schmitt and Xanthopoulos, *supra*.

The Likely Savings Behavior of Automatic IRA Participants

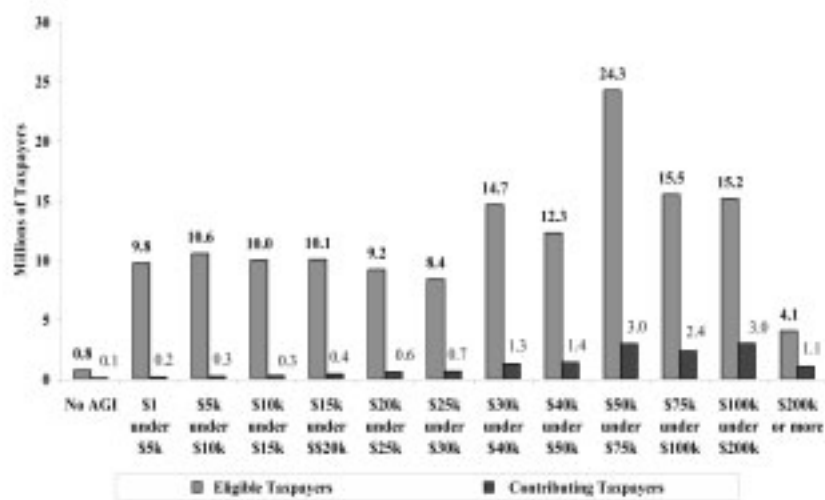
It is difficult to estimate with any certainty what the response to Automatic IRAs might be. Unlike existing IRAs that have particularly low levels of participation among lower-income taxpayers, Automatic IRAs may be structured more like a 401(k) plan with automatic enrollment. If employers embrace the automatic enrollment structure for Automatic IRAs and utilize scheduled automatic increases in contribution rates, Automatic IRAs have the potential to create significant increases in retirement savings among the low and moderate income workers who are least likely to be saving for retirement now.

While IRA participation under current law hovers around 10 percent of those eligible, typically around 85 percent of workers eligible for any employer-sponsored retirement plan participate.¹⁹ This suggests workplace-based access to Automatic IRAs would increase participation substantially, filling an important gap in retirement savings coverage. The low participation in current law IRAs suggests that many individuals have difficulty saving on their own. The Automatic IRA would overcome this difficulty by creating a small regular contribution with every pay period.

¹⁹ US Department of Labor, Bureau of Labor Statistics, National Compensation Survey: Employee Benefits in Private Industry in the United States, March 2006, page 1.

Graph 2 Eligible Taxpayers and Taxpayers Contributing to All IRAs, by AGI, Tax Year 2004

Source: IRS SOI, Accumulation and Distribution of IRAs, 2004



Accumulated Benefits

As Automatic IRA savings participation increases for uncovered workers, the potential for greater accumulated balances grows. Automatic IRAs would help to provide a bridge in retirement plan coverage for mobile workers who move from job to job and would make it more likely that workers will accumulate retirement savings over their full working career. Table 2 shows how dramatically total savings can increase over a working career.

If an individual has only five years until retirement, that person might expect to accumulate approximately \$4,500 if they defer \$750 per year (or 3 percent of salary for a worker earning \$25,000). However, deferring the same amount, a younger person might expect to accumulate approximately \$62,900 saving continuously for 30 years.

Increasing contributions with consistent, continuous savings would produce significantly greater savings balances. If an individual has only five years until retirement, that person might expect to accumulate approximately \$18,000 if they defer \$3,000 per year. However, deferring the same amount, a younger person might expect to accumulate approximately \$251,500 saving continuously for 30 years.

Table 2 – Sample Account Balances for Selected Annual Contribution Amounts and Selected Years of Participation
(Rate of Return = 6 percent, Amounts rounded up to the nearest \$100)

	\$750	\$1,000	\$2,000	\$3,000
5 years	\$ 4,500	\$ 6,000	\$ 12,000	\$ 18,000
10 years	\$ 10,500	\$ 14,000	\$ 28,000	\$ 42,000
15 years	\$ 18,600	\$ 24,700	\$ 49,400	\$ 74,100
20 years	\$ 29,300	\$ 39,000	\$ 78,000	\$ 117,000
25 years	\$ 43,700	\$ 58,200	\$ 116,400	\$ 174,500
30 years	\$ 62,900	\$ 83,900	\$ 167,700	\$ 251,500

The Saver's Credit

The Saver's Credit will interact with Automatic IRAs by providing an additional incentive for low- and moderate-income workers to save. The current law Saver's Credit increases the incentives for low and moderate-income individuals to make retirement savings contributions by providing an annual income tax credit of up to 50 percent of \$2,000 of contributions to qualified retirement savings plans. As such, the Saver's Credit could provide a boost to retirement savings participation by the lower income taxpayers targeted to benefit from Automatic IRAs. However, nonrefundability and the rapid phase-out of the current-law credit tend to reduce its effectiveness.

Nonrefundability of the credit – Nonrefundability of the Saver's Credit significantly limits the benefit of the credit for the low-income taxpayers who could most use it. In a recent analysis of the Saver's Credit, Gary Koenig and Robert Harvey found that many taxpayers are ineligible for the full 50-percent Saver's Credit rate because of nonrefundability of the credit.^[11] They found that 43 percent of taxpayers claiming the Saver's Credit in 2002 had the amount of their credit limited by nonrefundability. Further, they estimated that 89 percent of taxpayers who made retirement savings contributions eligible for the Saver's Credit would have had their credit limited by nonrefundability if they had made the maximum contribution permitted.^[12]

Income levels of the credit – The 50 percent credit rate is reduced to 20 percent, 10 percent, and zero as income rises. The income levels at which the Saver's Credit is available limits the effectiveness of the credit for many taxpayers. For 2008, the 50 percent credit rate is available for married couples filing a joint return with adjusted gross income of not more than \$32,000 (\$16,000 in the case of a single individual); the income levels at which the 20-percent and 10-percent credit rates are reduced are \$34,500 and \$53,000, respectively, for married couples filing jointly (\$17,250 and \$26,500, respectively, for single individuals). Expansion of the

^[11] Koenig, Gary and Harvey, Robert. *Utilization of the Saver's Credit: An Analysis of the First Year*. National Tax Journal, Vol. LVIII, No. 4, December 2005.

^[12] According to Koenig and Harvey's calculations, taxpayers claimed \$1.058 billion in Saver's Credits for 2002, but were eligible to claim \$1.752 billion. This translates to a claimed rate of 60 percent.

income levels would encourage more middle-income taxpayers to utilize the Saver's Credit and would provide a more meaningful savings incentive for lower-income taxpayers.

Cliff effects of the Saver's Credit – There is no income phase-out for the Saver's Credit rates; rather, the credit rate falls from 50 to 20 percent (or from 20 to 10 percent, or from 10 percent to zero) with the addition of just one more dollar of income earned. These income cliffs have the effect of imposing a high marginal tax rate on taxpayers who have income just above the cliff level. Cliffs also make it difficult for taxpayers to know whether they will be eligible for a credit, and if so, at what rate, before filing their tax return. Changing the income cliffs to a gradual income phase-out would do much to smooth the effects of these high marginal tax rates and eliminate uncertainty, and would make the Saver's Credit more consistent with most other tax incentives that phase out for higher income levels.

Improvements to the Saver's Credit to correct these drawbacks would make the Automatic IRA even more effective in increasing retirement savings among low and moderate-income workers.

Conclusion

Automatic IRAs create the potential help for finally filling the gaps in retirement savings coverage in the United States. Automatic IRAs will be particularly beneficial to many low-wage workers who do not currently have access to an employer-sponsored retirement plan.

While it is difficult to predict how successful Automatic IRAs might be in bridging the gap in retirement plan coverage faced by half of the U.S. workforce, evidence suggests that design features that encourage automatic enrollment could lead to substantial rates of participation even among lower-income workers. Enhancements to the Saver's Credit might further improve the chances that these lower-income workers will have both the means and the incentive to contribute toward their retirement savings.

Chairman NEAL. Thank you, Mr. Estrada.
Now I would like to recognize Mr. Iwry.

STATEMENT OF J. MARK IWRY, NONRESIDENT SENIOR FELLOW, THE BROOKINGS INSTITUTION; PRINCIPAL, THE RETIREMENT SECURITY PROJECT AND RESEARCH PROFESSOR, GEORGETOWN UNIVERSITY

Mr. IWRY. Chairman Neal, Ranking Member English, other Members of the Subcommittee, I am Mark Iwry, with the Brookings Institution. My written statement has been submitted jointly with my colleague, David John, a senior fellow with the Heritage Foundation. We are both also principals of the Retirement Security Project, a non-partisan partnership of Georgetown University and Brookings, supported by the Pew Charitable Trust. The two of us would be appearing here together, but for the fact that Mr. John is in the United Kingdom, counseling with officials there on very similar issues.

He and I would first like to express our appreciation to you, Mr. Neal, and you, Mr. English, for your leadership in introducing this bipartisan automatic IRA legislation which embodies our joint proposal, as well as to Mr. Emanuel, Mr. McDermott, Mr. Larson, Ms. Schwartz, and Mr. Blumenauer, as well as other Members of the House and the Senate, for cosponsoring your legislation.

As you know, the automatic IRA is intended to create a breakthrough in pension coverage, to break that 50 percent barrier that's been keeping half of the American work force from having access to easy ways to save at the workplace, and to do that by staking out common ground that transcends partisan and ideological differences.

The auto-IRA approach, as you know, is simple. It would give the 75 million American workers who have no employer-sponsored retirement plan the chance, through automatic enrollment, to save, to build wealth by using their employer's payroll system to send their own pay to their own IRA.

This would be done by combining three familiar building blocks from our current system, which we know work effectively: number one, saving through payroll deductions in the workplace, similar to the 401(k) mechanism; number two, automatic enrollment into payroll-based saving, which Congress strongly encouraged in the Pension Protection Act of 2006 in its 401(k) auto-enrollment provisions, and which is sweeping the 401(k) market; and third, IRAs, which are well established and portable.

IRAs make sense in a market-led proposal such as this. They have a \$5,000 maximum annual contribution level, which is high enough to meet the needs of most Americans—\$6,000 if you're age 50 or older—but it's low enough to avoid competing with 401(k) plans, which allow the individual to contribute \$15,500, \$5,000 more if you're age 50 or older, and, combining with individual and employer contributions, \$46,000 a year, compared to the \$5,000 in an IRA.

Specifically, here is how the automatic IRA would work. A new employee gets a standard notice, perhaps part of the IRS form W-4, telling the employee about the option to contribute to an IRA through the employer's payroll system, telling them they're auto-

matically enrolled at 3 percent of pay in a default investment that would probably be something like a low-cost, life-cycle, highly diversified fund, and telling them that they can opt out if they wish to, or opt for a higher or lower level of saving, consistent with the IRA rules.

An employer then simply forwards the money, whatever the employee elected, to an IRA provided by a financial institution. The employer does not contribute anything, does not make any outlay, does not comply with plan qualification rules, does not have to comply with ERISA, does not choose the investments, doesn't have to do anything other than keep track of what employees elected and pass on the money.

If the employer wants to avoid choosing a particular IRA provider, that's the employer's option. It can choose a provider that it prefers, does business with, et cetera, that marketed it, or it can say, "I don't want any part of that," and opt for a fall-back entity that would guarantee everyone has access to IRAs, even if their employer is not marketed by any IRA trustee or custodian. That would probably be a consortium or pool of private financial institutions, by contract.

The bill would call on employers that are not willing to sponsor any kind of plan—any 401(k) or other plan—that have more than 10 employees, that have been in business for more than 2 years to do this, to act simply as a conduit for the employee's money into the employee's IRA. Even though those employers would not make any contributions, they would get a small temporary tax credit that would even be available to employers who are not required to provide the payroll deduction as an incentive.

Mr. Chairman, Mr. English, this would all dovetail nicely with the saver's credit—and I would be happy to address that in Q&A—and would work very well for people, even who are not in the work force, by encouraging them, through automatic debit, to save more in IRAs. Thank you.

[The prepared statement of Mr. Iwry follows:]

The Retirement Security Project

RSP



CONGRESSIONAL TESTIMONY

**PURSUING UNIVERSAL RETIREMENT SECURITY
THROUGH AUTOMATIC IRAS**

**Testimony before the
Subcommittee on Select Revenue Measures
Committee on Ways and Means
United States House of Representatives**

June 26, 2008

David C. John
Principal
The Retirement Security Project
Senior Research Fellow
The Heritage Foundation

J. Mark Iwry
Principal
The Retirement Security Project
Nonresident Senior Fellow
The Brookings Institution

PURSUING UNIVERSAL RETIREMENT SECURITY THROUGH AUTOMATIC IRAS

Testimony before the Subcommittee on Select Revenue Measures Committee on Ways and Means United States House of Representatives

June 26, 2008

Chairman Neal, Ranking Member English, and Members of the Subcommittee, we appreciate the opportunity to testify before you.¹ We are submitting our testimony as a single joint statement because we believe strongly in the need for a common strategy to expand retirement savings in a manner that transcends ideological and partisan differences.

Our statement focuses on your bill -- H.R. 2167, The Automatic IRA Act -- which had its genesis in our joint proposal to expand retirement savings for small business workers². We are pleased by the positive responses the proposal has received and are grateful to you for introducing and sponsoring it, and to our

¹ **Mark Iwry** is a Principal of the Retirement Security Project, a Nonresident Senior Fellow at the Brookings Institution, Research Professor at Georgetown University, and formerly the Benefits Tax Counsel, in charge of national private pension policy and regulation, at the U.S. Department of the Treasury. **David John** is a Principal of the Retirement Security Project and a Senior Research Fellow for Retirement Security and Financial Institutions at the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation. (Biographical information attached.)

The Retirement Security Project is supported by The Pew Charitable Trusts in partnership with Georgetown University's Public Policy Institute and the Brookings Institution.

The views expressed in this testimony are those of the two witnesses and the Retirement Security Project, but should not be attributed to The Heritage Foundation, the Brookings Institution, Georgetown University's Public Policy Institute, The Pew Charitable Trusts, or any other organization.

² This testimony is based on a more detailed proposal the witnesses have set forth in a series of research and policy papers (see, e.g., Retirement Security Project Publication No. 2007-2 "Pursuing Universal Retirement Security through Automatic IRAs") which are available at www.retirementsecurityproject.org. (Major portions of this testimony are taken verbatim from the witnesses' research and policy papers cited above.) As noted, the proposal has been introduced in the 110th Congress as the "Automatic IRA Act of 2007", H.R. 2167, sponsored by Rep. Richard Neal (D-MA) and Rep. Phil English (R-PA), and S. 1141, sponsored by Senators Jeff Bingaman (D-NM) and Gordon Smith (R-OR), with additional cosponsors in the House and Senate.

This testimony also briefly addresses the Report of the Government Accountability Office ("GAO") to the Committee titled "Individual Retirement Accounts: Government Actions Could Encourage More Employers to Offer IRAs to Employees" (GAO-08-590, June 2008) (the "GAO Report").

colleagues, including those in government and in various stakeholder organizations, who have contributed to the ideas reflected in the proposal.³

With the looming retirement security crisis facing our country, policy-makers from both parties are focused on ways to strengthen pensions and increase savings. Our proposal for automatic IRAs would provide a relatively simple, cost-effective way to increase retirement security for the 75 million Americans working for employers (usually small businesses) that do not offer a retirement plan.⁴ It would enable these employees to save for retirement by allowing them to have their employers regularly transfer amounts from their paycheck to an IRA.

These people – half of our workforce – have no effective way to save at work. This fact, a national saving rate that has been declining steadily since the 1980s (to the point where it has dropped below zero), and the expectation that Social Security is unlikely to provide increased benefits, make inadequate retirement saving a major national problem. Research and experience both point to a simple and effective solution, which your bill calls the "automatic IRA."

We are by no means suggesting that the automatic IRA proposal is the only step that should be taken to expand retirement savings for small business workers or others. In fact, we have long believed in the primacy of employer-sponsored retirement plans as vehicles for pension coverage.⁵ Additionally, the Retirement Security Project continues to advocate strongly for the expansion of pension coverage through automatic features in 401(k) and similar retirement savings

³ See <http://www.retirementsecurityproject.org/pubs/Files/AutoIRAQuoteSheetFinal7.6.07.pdf>. Crenshaw, Albert, "Automatic IRAs – a Quick Fix for Workers Without Pensions?" *Washington Post*, February 19, 2006; "The Way to Save" Editorial, *New York Times*, February 20, 2006; Bernard, Tara, "Groups Propose Payroll Deductions for IRAs," *The Wall Street Journal*, February 16, 2006; Editorial, *Newsday*, February 22, 2006; Marketwatch.com (February 16, 2006); Lambro, Donald, "A Broader Retirement Plan," *The Washington Times*, April 12, 2007; "Another Black Eye for H&R Block" Editorial, *New York Times*, March 18, 2006; Quinn, Jane Bryant, "A Nest Egg for Low Earners," *Newsweek*, February 26, 2007; Commission on the Regulation of U.S. Capital Markets in the 21st Century, Report and Recommendations, March 2007. The automatic IRA proposal emerged as one of the leading recommendations of the 2006 National Summit on Retirement Savings (Saver Summit).

⁴ Craig Copeland, "Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2005: Employee Benefit Research Institute Issue Brief No. 299," November 2006 (referred to below as "Copeland, EBRI Issue Brief No. 299"), Figure 1, p. 7. An additional 16 million workers either are not eligible for their employer's plan or are eligible but fail to participate. Similar but updated figures for 2006 are available in the Employee Benefit Research Institute Issue Brief 311.

⁵ We have previously written and testified before Congress on various aspects of employer-sponsored retirement plans. David John has written and testified about the funding problems faced by defined benefit pension plans and about the United Kingdom's pension situation. Mark Iwry led the Executive Branch efforts in the 1990s to develop the SIMPLE plan for small business, the startup tax credit for small employers that adopt new plans, and the saver's credit for moderate- and lower-income workers, as well as the Executive Branch initiatives to define, approve and promote 401(k) automatic enrollment, automatic rollover to restrict pension leakage, and automatic 401(k) features generally. See also William G. Gale, J. Mark Iwry and Peter R. Orszag, "The Saver's Credit" (The Retirement Security Project, Policy Brief No. 2005-2; available at www.retirementsecurityproject.org).

plans⁶ and for several other initiatives designed to expand retirement security, especially for the moderate- and lower-income households that comprise a majority of the U.S. population.⁷

Making saving easier by making it automatic has been shown to be remarkably effective at boosting participation in 401(k) plans, but roughly half of U.S. workers are not offered a 401(k) or any other type of employer-sponsored plan. We would extend the benefits of automatic saving to a far wider array of the population by combining several key elements of our current system: payroll deposit saving, automatic enrollment, low-cost, diversified default investments, and IRAs.

The automatic IRA approach we propose offers most employees not covered by an employer-sponsored retirement plan the opportunity to save through the powerful mechanism of regular payroll deposits that continue automatically. The employer's administrative functions are minimal and should involve no out of pocket cost. In addition, the arrangement is market-oriented and realistic: it uses a well established and familiar vehicle, IRAs, provided by the same banks, mutual funds, insurance carriers, brokerage firms, credit unions, and other private financial institutions that currently provide them. As a fallback, if individuals or employers could not find an acceptable IRA on the market, they would be able to use ready-made, low-cost automatic IRA accounts provided by a consortium or pool of private-sector financial institutions or another nonprofit or government-contracted entity that contracts out asset management and other functions to the private sector.

The Basic Problem

In 2004 half of all households headed by adults aged 55 to 59 had \$13,000 or less in an employer-based 401(k)-type plan or tax-preferred saving plan

⁶ William G. Gale, J. Mark Iwry and Peter R. Orszag, "The Automatic 401(k): A Simple Way to Strengthen Retirement Savings," (The Retirement Security Project, Policy Brief No. 2005-1; available at www.retirementsecurityproject.org); William G. Gale and J. Mark Iwry, "Automatic Investment: Improving 401(k) Portfolio Investment Choices" (The Retirement Security Project, Policy Brief No. 2005-4; available at www.retirementsecurityproject.org).

See also the description of the joint AARP, FINRA, Retirement Security Project "Retirement Made Simpler" campaign, below.

⁷ See, for example, the following (all of which are available at www.retirementsecurityproject.org): J. Mark Iwry, William Gale, and Peter Orszag, "The Potential Effects of Retirement Security Project Proposals on Private and National Saving: Exploratory Calculations," Retirement Security Project Policy Brief No. 2006-2; Peter Orszag and Eric Rodriguez, "Retirement for Latinos: Bolstering Coverage, Savings and Adequacy," Retirement Security Project Policy Brief No. 2005-7; William G. Gale, J. Mark Iwry and Peter R. Orszag, "The Saver's Credit," Retirement Security Project Policy Brief No. 2005-2; J. Mark Iwry, "Using Tax Refunds to Increase Savings and Retirement Security," Retirement Security Project Policy Brief No. 2005-9; Peter Orszag, "Protecting Low-Income Families' Savings: How Retirement Accounts Are Treated in Means-Tested Programs and Steps to Remove Barriers to Retirement Saving," Retirement Security Project Policy Brief No. 2005-6.

account.⁸ The U.S. personal saving rate has declined steadily over the last two decades, to the point where it recently dropped below zero.⁹

Moreover, traditional corporate defined benefit pension plans are declining, and few expect Social Security to provide increased benefits in the future. The households that tend to be in the best financial position to confront retirement are the 41 percent of the workforce that participate in an employer-sponsored retirement plan.¹⁰

The most vulnerable employees are those lacking access to an employer-sponsored plan. In a survey conducted by AARP with 700 private sector workers at companies with 10-250 employees that do not offer a 401(k) or some other retirement plan, fewer than half of these workers without access to an employer plan said they had taken the following actions: Saved money in a non-retirement account (45%); Saved money in a retirement account (35%); Read articles or other information about retirement (35%); Talked with friends, relatives, and/or coworkers about retirement (31%); Used a retirement calculator (14%).¹¹

Generally, the rate of participation (those who contribute as a percentage of those who are eligible) for 401(k) plans is on the order of 7 or 8 out of 10. An increasing share of plans are including automatic features that make saving easier and raise participation, often to levels exceeding 9 out of 10. While more can and should be done to expand 401(k) and other employer plan coverage,¹² the fraction of the workforce that is covered by employer plans has hovered around half for at least three decades. The uncovered employees have no effective way to save at work. IRAs do not cover enough people because many fail to exercise the initiative required to make the decisions and take the actions necessary to save in an IRA. More broadly, many people find it too difficult or lack the financial sophistication to plan for retirement and defer consumption. As a result, only about 1 in 10 eligible individuals contributes to an IRA.

A Note on IRAs in the Workplace

IRAs in the workplace are the topic of the June 2008 GAO Report referred to earlier. The GAO Report notes that, as of 2004, IRAs held about \$3.5 trillion in

⁸ Even among those households that had savings in 401(k)s and IRAs, the median account balance was only \$69,000. Authors' calculations using the 2004 Survey of Consumer Finances.

⁹ As measured in the National Income and Product Accounts.

¹⁰ Copeland, EBRI Issue Brief No. 299, Figure 1, page 7. Similar but updated figures for 2006 are available in the Employee Benefit Research Institute Issue Brief 311.

¹¹ Thayer, Colette, "Automatic IRAs: Worker Attitudes and Likelihood of Participation," April 2007

¹² See William G. Gale, J. Mark Iwry, and Spencer Walters, *The Pension Protection Act of 2006 and the Unfinished Agenda*. (Retirement Security Project Publication No. 2007-1, April 2007).

assets, compared to \$1.9 trillion in employer-sponsored defined benefit ("DB") pension plans and \$2.6 trillion in employer-sponsored 401(k) and other defined contribution ("DC") plans. (More recent data suggest that these relationships have not changed fundamentally.)

Most current IRA assets were not contributed directly to IRAs but came from tax-free rollovers from employer-sponsored DB or DC plans. As evidenced by the dramatic difference in participation rates noted earlier, employer plans have been a far more effective means of generating participation and contributions than the opportunity to contribute to a non-workplace-based ("standalone") IRA. This is attributable to employer contributions (matching and nonmatching), the power of regular payroll deduction that automatically continues making regular small contributions, automatic enrollment, default investments and other automatic (default) features, employer-provided education and encouragement to save, economies of scale associated with group saving arrangements, peer group reinforcement, and other factors.

We address the GAO Report briefly toward the end of this testimony.

The Automatic IRA

The Automatic IRA legislation is designed to overcome the obstacles to saving in IRAs. It would give the uncovered half of our workforce an easy, effective way to save through automatic enrollment into payroll deposit IRAs. The AARP-commissioned study shows that workers at companies that would be covered by automatic IRAs favor the automatic IRA concept and are likely to participate: Over seven in ten (71%) of those without access to an employer-provided retirement savings plan agree that "employers who do not offer a 401(k) or other retirement plan should be required by law to offer workers the option to regularly save a part of their paycheck in an individual retirement account" and nearly eight in ten (79%) of those without access say they would be likely to participate if their company offered them the option to regularly save a part of their paycheck in an IRA through payroll deduction.

Very similar results were obtained in a study conducted by Prudential Insurance Company, titled "Saving for Retirement at Work: Employee and Business Reactions to an Automatic IRA Concept". The Prudential research found that eight in ten employees were interested in the proposed automatic IRA. The study reported, "Employees are positive in their reaction to the Automatic IRA, both in concept and after learning the specific details. *In fact, the more employees learn about the Automatic IRA, the more they are interested in it.*" [original emphasis]¹³

¹³ Prudential Insurance Company of America, "Saving for Retirement at Work: Employee and Business Reactions to an Automatic IRA Concept," page 19.

In addition, the Prudential study surveyed more than 200 small employers. It found that "Eight in 10 businesses believe the design overcomes their concerns, and support the adoption of the Automatic IRA. . . . The more they heard about its features, the more they liked it."¹⁴

The Prudential research concluded,

"The Automatic IRA can generate "new" savings, rather than merely shifting savings from one vehicle to another. Of the 80% of employees who were "very/somewhat" interested in the Automatic IRA, 68% believe it will generate real additional savings. Projecting this rate to all eligible employees suggests that new savings might be gained by about 54% of eligible employees."¹⁵

How the Automatic IRA Would Work

The automatic IRA approach is intended to help households overcome the barriers to saving by building on the successful use in 401(k) plans of automatic features which encourage employees toward sensible decisions while allowing them to make alternative choices. The automatic IRA would feature direct payroll deposits to a low-cost, diversified IRA. Employers above a certain size (e.g., 10 employees) that have been in business for at least two years but that still do not sponsor any plan for their employees would be called upon to offer employees this payroll-deduction saving option. The automatic IRA would apply many of the lessons learned from 401(k) plans so that more workers could enjoy automated saving to build assets – without imposing any significant burden on employers. Employers that do not sponsor plans for their employees could facilitate saving – without sponsoring a plan, without making employer matching contributions, and without complying with plan qualification or fiduciary standards. They would simply offer to act as a conduit, remitting a portion of employees' pay to an IRA, preferably by direct deposit, at little or no cost to the employer.

The automatic IRA is also designed to address the concern that financial providers have found it less profitable to serve groups of people with a small average account size. The proposal would provide a backstop arrangement contracted to the private sector that would give an option to any employee groups that the financial services industry is not currently interested in serving.

Little or No Cost to Employers

Direct deposit to IRAs is not new. In the late 1990s, Congress, the IRS, and the

¹⁴ Id. at 20. Prudential stated that "to obtain unbiased objective reactions to the ability of the concept to meet their established concerns about retirement programs and specific needs for the future," it did not tell employers until the last part of the survey that the proposal would require, not merely permit, certain employers to adopt automatic IRAs. (The optional approach to payroll deposit IRAs has been tried and has resoundingly failed. Payroll deposit IRAs have been permitted for at least a decade, and were publicized by the U.S. Treasury and Labor Departments in the 1990s, but virtually no employers have adopted them.)

¹⁵ Id. at 20.

Department of Labor all encouraged employers not ready or willing to sponsor a retirement plan to at least offer their employees the opportunity to contribute to IRAs through payroll deduction.¹⁶ However, employers generally did not respond to this option. As noted, few employers have ever adopted direct deposit or payroll-deduction IRAs – at least in a way that actively encourages employees to take advantage of the arrangement.

With this experience in mind, your bill proposes a new strategy designed to induce employers to offer, and employees to take up, direct deposit or payroll deposit saving. For many if not most employers, offering direct deposit or payroll deduction IRAs would involve little or no cost. The employer would not be maintaining a retirement plan, and employer contributions would be neither required nor permitted. Firms would not be required to

- (1) comply with plan qualification or ERISA¹⁷ rules,
- (2) establish or maintain a trust to hold assets,
- (3) determine whether employees are actually eligible to contribute to an IRA or are complying with the limits on contributions,
- (4) select investments for employee contributions,
- (5) select among IRA providers, or
- (6) set up IRAs for employees.

Employers would be required simply to allow employees to make a payroll-deduction deposit to IRAs. This dovetails with what employers are already required to do by way of withholding income (and payroll) tax from employees' pay (based partly on employee elections on IRS Form W-4) and remitting those amounts to the federal tax deposit system.

Tax Credit for Employers that Serve as Conduit for Employee Contributions

Firms that do not provide employees a qualified retirement plan, such as a pension, profit-sharing, or 401(k) plan, would be given a temporary tax credit to establish automatic IRAs. The tax credit would be available to a firm for the first two years in which it offered payroll deposit saving to an IRA and would be

¹⁶ In the Conference Report to the Tax Reform Act of 1997, Congress stated that "employers that choose not to sponsor a retirement plan should be encouraged to set up a payroll deduction [IRA] system to help employees save for retirement by making payroll-deduction contributions to their IRAs" and encouraged the Secretary of the Treasury to "continue his efforts to publicize the availability of these payroll deduction IRAs" (H.R. Rep. No. 220, 105th Cong., 1st Sess. 775 [1997]). IRS and Labor guidance was given in IRS Announcement 99-2, "Payroll Deduction IRAs," and Department of Labor Interpretive Bulletin 99-1 (June 18, 1999), 29 C.F.R. 2509.99-1(b).

¹⁷ Employee Retirement Income Security Act of 1974, as amended.

designed to avoid competing with the tax credit available under current law to small businesses that adopt a new employer-sponsored retirement plan. Also, it would be available both to those employers required to offer payroll deposit and to very small or new firms that are not required to but do so voluntarily.

Tax Credit for Employers that Adopt a New Employer-Sponsored Retirement Plan

Under current law, an employer with 100 or fewer employees that starts a new retirement plan for the first time can generally claim a tax credit for startup costs. The credit equals 50 percent of the cost of establishing and administering the plan (including educating employees about the plan) up to \$500 per employer per year for three years. To maintain employer incentives to adopt an employer plan, the automatic IRA tax credit would be lower, e.g. \$25 per employee enrolled, capped at \$250 in the aggregate per employer. Employers could not claim both the new plan startup credit and the proposed automatic IRA credit.

Direct Deposit and Automatic Fund Transfers

The automatic IRA would capitalize on automated or electronic fund transfers. Many employers retain an outside service provider to manage payroll, including withholding, federal tax deposits, and direct deposit of paychecks to accounts designated by employees or contractors. For the numerous firms that already offer their workers direct deposit, direct deposit to an IRA would entail no additional cost, even in the short term. A large proportion of the employers that still process their payroll by hand would be exempted under the exception for very small employers. As a result, our proposal focuses chiefly on those employers that already use electronic payroll but have not used the same technology to provide employees a convenient retirement saving opportunity. Employers that do not use electronic payroll would have the option of "piggybacking" the payroll deposits to IRAs onto the federal tax deposits they currently make, whether online, by mail, or by delivery to the local bank.

Employees Covered

Employees eligible for the automatic IRA would include those who have worked for the employer on a regular basis (including part-time) for a specified period of time and whose employment there is expected to continue. Employers would not be required to offer automatic IRAs to employees who are already covered by a retirement plan or are excludable from coverage (such as recently-hired employees, those who work less than 1,000 hours a year, union-represented employees or nonresident aliens without US source income) under the qualified plan rules. Accordingly, the proposal is not intended to apply to employers that

offer 401(k), SIMPLE, pension or other qualified retirement plans to their employees.¹⁸

Portability of Savings Through Choice of Roth or Traditional IRA

Like a 401(k) contribution, the amount elected by the employee as a salary reduction contribution generally would be tax-favored. It either would be a contribution to a Roth IRA, which receives tax-favored treatment upon distribution, or a "pre-tax" contribution to a traditional, tax-deductible IRA. To spare households the need to undertake the comparative analysis of Roth versus traditional IRA, one or the other would be the default or presumptive choice. Of course, presented with an automatic or standard option, many households will simply go along with it, while others will consider whether to choose the other alternative. Accordingly, the automatic approach strikes a balance between simplicity and individual choice. In either case, the use of IRAs maximizes portability of savings. IRAs generally continue in existence without regard to changes in the owner's employment status and, in general, are freely transferable by rollover to other IRAs or qualified plans.

Expanding Saving through Automatic Features

Obstacles to Participation

Today, individuals who want to save in an IRA must make a variety of decisions to open an account. In addition, they must overcome a natural tendency to delay making important decisions until the last minute. At least five key questions are involved:

- whether to participate at all;
- which financial institution to use to open an IRA (or, if they have an IRA already, whether to use it or open a new one);
- whether the IRA should be a traditional or Roth IRA;
- how much to contribute to the IRA; and
- how to invest the IRA.

These obstacles can be overcome by making participation easier and more automatic.

Automatic Enrollment or an Explicit "Up or Down" Employee Election

¹⁸ The only exception would be an employer that sponsored a retirement plan but excluded a major portion of its workforce – for example, excluding an entire division or subsidiary that is not union-represented or foreign – in which case the employer would be required to offer payroll deposit saving to the rest of the workforce.

Automatic enrollment (more often applied to newly hired employees but now increasingly applied to both new hires and other employees) has produced dramatic increases in 401(k) participation.¹⁹ In view of the basic similarities between employee payroll-deduction saving in a 401(k) and under a direct deposit IRA arrangement, the law should, at a minimum, permit employers to automatically enroll employees in direct deposit IRAs.

However, simply allowing employers to use automatic enrollment with direct deposit IRAs may not be enough. Requiring employers to use automatic enrollment in conjunction with the payroll deduction IRAs (with a tax credit and legal protections) likely would increase participation dramatically while preserving employee choice. However, a workforce that presumably has not shown sufficient demand for a retirement plan to induce the employer to offer one might react unfavorably to being automatically enrolled in direct deposit savings without a matching contribution. In addition, some small business owners who work with all of their employees closely each day might regard automatic enrollment as unnecessary.

Accordingly, automatic enrollment would be the presumptive or standard enrollment method, but employers could opt out of it in favor of an alternative approach, which is in effect a variation on automatic enrollment. The alternative requires all eligible employees to submit an election that explicitly either accepts or declines payroll deposit to an IRA. Requiring an "up or down" election picks up many who would otherwise fail to participate because they do not complete and return the enrollment form due to procrastination, inertia, inability to decide on investments or level of contribution, and the like.²⁰ Any employee who fails to comply with the election requirement is automatically enrolled. In either case, to maximize participation, employers receive a standard enrollment module reflecting current best practices in enrollment procedures.²¹

In addition, employees like automatic enrollment. Retirement Made Simpler -- a coalition of advocacy, regulatory and policy organizations, including AARP, the Financial Industry Regulatory Authority (FINRA), and the Retirement Security Project (RSP) -- was launched to encourage employers to help their employees

¹⁹ Brigitte Madrian and Dennis Shea, "The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior," *Quarterly Journal of Economics* 116, no. 4 (November 2001): 1149-87; and James Choi and others, "Defined Contribution Pensions: Plan Rules, Participant Decisions, and the Path of Least Resistance," in *Tax Policy and the Economy*, vol. 18, edited by James Poterba (Cambridge, Mass.: MIT Press, 2002), pp. 67-113. See also Sarah Holden and Jack VanDerhei, "The Influence of Automatic Enrollment, Catch-Up, and IRA Contributions on 401(k) Accumulations at Retirement," *Employee Benefit Research Institute Issue Brief No. 283* (July 2005).

²⁰ James Choi, David Laibson, Brigitte Madrian, and Andrew Metrick, "Optimal Defaults and Active Decisions," NBER Working Paper No. 11074 (January 2005).

²¹ A national website could provide firms these standard enrollment and election forms, as well as provide an opportunity to promote employee education and best practices as they evolve, such as automatic enrollment and potentially, lifetime guaranteed income.

be better prepared financially for retirement. Retirement Made Simpler recently released a survey on employee satisfaction with automatic enrollment. The survey, a first of its kind, reached out to employees who work at firms that use automatic enrollment. The results are striking. Of these employees, 97% agreed that they were satisfied with automatic enrollment, and 74% of them were "very satisfied." Agreement that automatic 401(k) has helped them start saving for retirement earlier than planned is 85%, with 62% at "Strongly agree". And agreement that automatic enrollment has made saving for retirement easy is 95%, with 71% at "Strongly agree." Even among those who opted out of their company's 401(k) plan, a full 79% were glad their company offered automatic enrollment to employees.

Compliance

Whether using automatic enrollment or explicit "up or down" elections from employees, employers would be required to obtain a written (including electronic) election from each nonparticipating employee. That way, no one would be left out by reason of inertia. If the employer chose to use automatic enrollment, the notice would also inform employees of that feature (including the automatic contribution level and investment and the procedure for opting out), and the employer's records would need to show that employees who failed to submit an election were in fact participating in the payroll deduction saving. Employers would be required to certify annually to the IRS that they were in compliance with the payroll deposit saving requirements.²²

Making a Saving Vehicle Available To Everyone

Under the automatic IRA, individuals who wish to direct their contributions to a specific IRA can do so. To make this happen, the employer has two choices:

- remitting all employee contributions in the first instance to IRAs at a single private financial institution (chosen by the employer), from which employees can transfer the contributions, without cost, to their own IRA, or
- if the employer or employees could not find an IRA provider willing to serve their market for an acceptably low fee, or if the employer preferred not to designate a particular financial institution for provide IRAs for

²² This might be done in conjunction with the existing IRS Form W-3 that employers file annually to transmit Forms W-2 to the government. Failure to offer payroll deposit saving would ultimately be backed up by an excise tax similar to (but much lower than) that imposed for employer violations of the COBRA health care continuation coverage requirements. The intent is that employers would never have to pay such an excise tax; it is simply a deterrent to noncompliance, accompanied by a rather forgiving array of exceptions, opportunities for correction, and relief for unintentional noncompliance that is generally patterned after the corresponding COBRA provisions. Compare Internal Revenue Code Section 4980B.

employees, employers and employees would have access to a standard fallback IRA account, as described below.²³

A Low-Cost Standard Automatic Account

The fallback arrangement, which might take the form of an industry consortium or nonprofit organization, would make a standard IRA account automatically available to receive direct deposit contributions from employees. These accounts would be maintained and operated by private financial institutions under contract with the federal government. By contrast to the wide-open array of investment options provided in most current IRAs (which can be daunting for many savers) and the high (and costlier) level of customer service provided in many 401(k) plans, the standard account would provide only a few investment options (to maximize economies of scale and reduce cost). It would permit individuals to change their investments only once or twice a year, and would emphasize transparency of investment and other fees and expenses. Like the investment options under the federal Thrift Savings Plan for federal employees, it is contemplated that costs could be minimized, for example, through the use of passive investments such as index funds provided and managed by private financial institutions or other private-sector investments that are similarly low-cost. This would not limit anyone's choices: individuals who preferred other IRA investments could simply continue contributing to an IRA outside the context of these proposed new arrangements.

Automatic Investment Fund Choice

The IRAs selected by employees or employers from among those offered by private financial institutions as well as the fallback standard IRAs would provide low-cost professional asset management to millions of savers, with a view to improving their aggregate investment results. To that end, these IRAs would offer an automatic or default investment fund (generally similar, at least initially, to the kinds of investments described as "Qualified Default Investment Alternatives" in Department of Labor regulations)²⁴ for all deposits unless the individual chose otherwise. This automatic investment choice could be a highly diversified "target asset allocation" or "life-cycle" fund comprised of a mix of equities and fixed income or stable value investments, and probably relying heavily on index funds or other cost-minimizing approaches. It could also make available some

²³ Moreover, nothing would prevent an employer willing to do so from following employee directions as is ordinarily done when employers make direct deposits of paychecks to accounts specified by employees.

²⁴ "Default Investment Alternatives Under Participant Directed Individual Account Plans: Final Rule," Department of Labor Employee Benefits Security Administration, Federal Register (Vol. 72, No. 205), October 24, 2007. See also letter from J. Mark Iwry, Principal, Retirement Security Project, to Department of Labor Employee Benefits Security Administration, dated November 13, 2006 (available at www.retirementsecurityproject.org), commenting on the Department's proposed regulations.

elements of guarantee against loss of principal, in exchange for a limited reduction in the rate of return.

One approach to minimize cost and maximize simplicity might be a temporary, short-term default investment in a guaranteed, principal-preserving option such as a bank certificate of deposit or other fixed income vehicle. Such a default would apply, if at all, only until account balances grew large enough to make them more self-sustaining.

Because it is desirable to maintain a degree of flexibility in order to accommodate and reflect market creativity, best practices, and the evolving consensus of expert financial advice over time, the proposed legislation would not fully specify the automatic investment. General statutory guidelines would be fleshed out at the administrative level after a process of extensive consultation with private-sector investment experts. In addition, the IRAs employees or employers select from private financial institutions would also offer at least a few investment alternatives, consistent with normal market practice, but would not be limited to any prescribed array of investment options.

Employers Protected from Risk of Fiduciary Liability

Employers making payroll deposits would be insulated from potential liability or fiduciary responsibility with respect to the manner in which direct deposits are invested in automatic IRAs, even if the IRA provider is selected by the employer. Nor would employers be exposed to potential liability with respect to any employee's choice of IRA provider or type of IRA. This protection of employers would be facilitated by regulatory designation of standard investment types that reduces the need for continuous professional investment advice. In addition, employers could avoid responsibility even for the selection of an IRA provider for their employees by specifying the government-contracted fallback automatic IRA (or, if the employer wished to, allowing each employee to specify his or her preferred IRA provider).

The Importance of Protecting Employer Plans

The automatic IRA proposal is designed carefully to avoid competing with or crowding out employer plans. Probably the most important protection for employer plans is the use of IRAs, which have maximum permitted contribution levels of \$5,000 (with an additional \$1,000 if the contributor is age 50 or older). This is sufficient to meet the demand for saving by millions of households but not high enough to satisfy the appetite for tax-favored saving of business owners or decision-makers, who can contribute up to \$15,500 of their own salary to a 401(k) (or \$20,500 if age 50 or older) plus matching or nonmatching employer contributions that can bring the total annual 401(k) contributions on their behalf to

\$46,000 a year.²⁵ In addition, by design, the employer tax credit for providing access to automatic IRAs is significantly less than the small employer tax credit for sponsoring a new 401(k), SIMPLE or other retirement plan.

In fact, the automatic IRA is designed to actually promote more employer plans. First, any employer that wants to match its employees' contributions must adopt a qualified plan or SIMPLE; to preserve that incentive, the automatic IRA does not allow employer contributions. Second, any small business owner or decisionmaker who wants to save more than \$5,000 or \$6,000 a year on a tax-favored basis would have an incentive to adopt a SIMPLE or 401(k). Finally, the automatic IRA gives consultants, third-party administrators, financial institutions, and other plan providers a new way to penetrate the small business pension market with 401(k)s, SIMPLEs and other tax-favored employer plans. Because these plans can now be purchased at very low cost, it would seem natural for many small businesses – especially those whose owner would like to save more or to match employees' saving – to graduate from payroll deduction saving and complete the journey to a qualified plan.

Encouraging Contributions by the Self-Employed and Independent Contractors

For the self-employed and others who have no employer, regular contributions to IRAs would be facilitated in four principal ways:

- Expanding access to automatic debit arrangements, including through professional and trade associations that could help arrange for automatic debit and direct deposit to IRAs. Automatic debit essentially replicates the power of payroll deduction insofar as it continues automatically once the individual has chosen to initiate it.
- Extending the payroll deposit option to many independent contractors through direct deposit with firms from which they receive regular payments (without affecting the individual's status as an independent contractor);
- Enabling taxpayers to direct the IRS to make direct deposit of a portion of their income tax refunds to an IRA (which became possible for the first time last year); and
- Allowing the self-employed to transmit IRA deposits with their quarterly estimated income taxes.

Matching Deposits as a Financial Incentive

A powerful financial incentive for direct deposit saving by those who are not in the higher tax brackets (and who therefore derive little benefit from a tax

²⁵ The IRA and 401(k) contribution limits (as well as the limits applicable to SIMPLE plans) are indexed for cost-of-living.

deduction or exclusion) would be a matching deposit to their payroll deposit IRA. By increasing assets under management, a match would also increase private financial institutions' interest in providing IRAs. One means of delivering such a matching deposit would be via the financial institution that provides the payroll deposit IRA. For example, the first \$500 contributed to an IRA by an individual who is eligible to make deductible contributions to an IRA might be matched by the private IRA provider on a dollar-for-dollar basis, and the next \$1,000 of contributions might be matched at the rate of 50 cents on the dollar. The financial provider would be reimbursed for its matching contributions through federal income tax credits.²⁶

Evidence from a randomized experiment involving matched contributions to IRAs suggests that a simple matching deposit to an IRA can make individuals significantly more likely to contribute and more likely to contribute larger amounts.²⁷ Matching contributions – similar to those provided by most 401(k) plan sponsors – not only would help induce individuals to contribute directly from their own pay, but also, if the match were automatically deposited in the IRA, would add to the amount saved in the IRA. The use of matching deposits would require procedures to prevent gaming – contributing to induce the matching deposit, then quickly withdrawing those contributions to retain the use of those funds.²⁸

Guaranteed Lifetime Income

The automatic IRA could also serve as a natural platform or proving ground for best practices in retirement savings, possibly including, over time, an expanded use of lifetime guaranteed income. There is reason to believe that many households with savings but no lifetime income stream to supplement Social Security would be better off if they converted a portion of their savings to (appropriately priced) guaranteed income. Yet most are reluctant to do so. The same automatic strategy used to promote enrollment and sensible investment could encourage more workers to obtain the security of an annuity or other guaranteed lifetime income, including perhaps "longevity insurance" that provides a deferred annuity beginning at age 80 or 85, for example. The attractiveness of lifetime income options is increasing as providers offer more features that are responsive to consumer concerns (such as death benefits, cash surrender

²⁶ This raises a number of issues. For further discussion, see discussion of proposed reforms of the Saver's Credit, e.g., William G. Gale, J. Mark Ivers, and Peter R. Orszag, "The Saver's Credit: Expanding Retirement Savings for Middle- and Lower-Income Americans" (Retirement Security Project Publication No. 2005-02, March 2005).

²⁷ Esther Dufo, William Gale, Jeffrey Liebman, Peter Orszag, and Emmanuel Saez, "Saving Incentives for Low- and Middle-Income Families: Evidence from a Field Experiment with H&R Block" (Retirement Security Project, May 2005).

²⁸ Among the possible approaches would be to place matching deposits in a separate sub-account subject to tight withdrawal rules and to impose a financial penalty on early withdrawals of matched contributions.

options, and products combining guaranteed minimum benefits with potential for growth). The uniform default investment and the backstop automatic IRA for any employees who cannot find an appropriate IRA in the market may lend themselves to exploring means of encouraging greater use of low-cost guaranteed income in IRAs generally as well as in 401(k) and other employer plans.²⁹

As former Chair of the Council of Economic Advisers Laura Tyson pointed out in a Wall Street Journal op-ed article endorsing the automatic IRA, "[j]ust as the Automatic 401(k) and Automatic IRA would help to ensure that employees have enough retirement savings, automatic guaranteed lifetime income would help to ensure that they do not outlive their savings"³⁰ and have an income stream they can count on.

A Note on the GAO Report

The June 2008 GAO Report on employer-provided IRAs calls for the collection of additional data on IRAs and potentially more regulatory oversight. We agree that additional data would be useful for various purposes, including potentially improving compliance and determining exactly in what ways IRAs are and are not working effectively to fill the gap in retirement savings for those not participating in employer plans. However, improved collection and reporting of data – such as the data referred to in the GAO Report on how many employers and employees currently use SIMPLE or SEP IRAs or payroll deduction IRAs – should be done in a way that does not impose undue burdens on employers, employees, or IRA providers. Moreover, significantly, our interest in obtaining such data need not and should not delay the development of a basic strategy to expand retirement saving using workplace IRAs.³¹

We already have sufficient evidence of certain fundamental facts that should drive the development of policy in this area. It is clear, for example, that –

²⁹ Accordingly, H.R. 2167 and S. 1141 require a joint study by the Labor and Treasury Departments of the feasibility and desirability of promoting the use of low-cost annuities, longevity insurance, or other guaranteed lifetime income arrangements in automatic IRAs, including consideration of – (i) appropriate means of arranging for, or encouraging, individuals to receive at least a portion of their distributions in some form of low-cost guaranteed lifetime income, and (ii) issues presented by possible additional differences in, or uniformity of, provisions governing different IRAs. Section 4(b)(1)(B). The bills also would provide for a joint study of the feasibility and desirability of extending to automatic IRAs spousal consent requirements similar to, or based on, those that apply under the Federal employees' Thrift Savings Plan, including consideration of whether modifications of such requirements are necessary to apply them to automatic IRAs. Section 4(b)(1)(A).

³⁰ Laura D'Andrea Tyson, "Some No-Brainer Savings Ideas," Wall Street Journal, October 30, 2007, page A-18.

³¹ As noted, the Prudential research found that, "of the 80% of employees who were 'very/somewhat' interested in the Automatic IRA, 68% believe it will generate real additional savings." (See text at n. 15, above.)

1. Participation in standalone (non-workplace) IRAs is dramatically less than in employer plans (for reasons noted earlier).
2. Payroll deduction IRAs at the workplace could provide much of the same impetus for saving and ease of saving that employer plans provide.
3. Of the many employers that do not sponsor employer plans, very few have adopted payroll deduction IRAs.
4. The cost to an employer of maintaining a payroll deduction IRA involves no employer contribution or other outlay, and therefore generally will be far less than the cost of sponsoring a plan that does involve employer contributions. Moreover, employers that allow employees to make payroll deposits to IRAs already function as a conduit or forwarding agent when they withhold and remit income tax from their employees' pay.
5. Data on the exact extent of employer adoption of payroll deduction IRAs to date do not reflect, and would not have much relevance to, a scenario in which employers would be required to provide them.
6. Since the 401(k) experience strongly suggests that automatic enrollment dramatically raises participation, data on the degree of employee participation in current payroll deduction IRAs (which do not use automatic enrollment) would be useful but not as relevant to the scenario in which employees would be automatically enrolled in payroll deduction IRAs.
7. Accordingly, a major expansion of payroll deduction IRAs using automatic enrollment could increase employees' retirement contributions dramatically.

It is true that we have little data bearing on certain ultimate issues relating to saving for retirement (in IRAs or employer plans) such as —

- The extent to which contributions to plans are offset by additional debt or by a reduction of the household's other balances or assets so that they do not, to that extent, represent real net saving.
- How durable the contributions are: do they leak out of the system or are they used for retirement purposes?

However, the lack of compelling evidence on such ultimate saving issues is not particular to IRAs; it is also true of 401(k)s and other employer plans. Even if the helpful data that is sought by GAO regarding IRAs were reported and collected, they would fall short of answering these questions in the case of IRAs. We cannot afford to suspend for several years all efforts to improve coverage and participation through the use of payroll deduction IRAs (and we do not believe

the GAO Report is suggesting that we do) in order to await the collection and analysis of data that, however useful, are unlikely to resolve the key issues involved in our policy decisions.

Conclusion

American households have a compelling need to increase their personal saving, especially for long-term needs such as retirement. This testimony summarizes a strategy to make saving more automatic – hence easier, more convenient, and more likely to occur. By adapting to the IRA universe practices and arrangements that have proven successful in promoting 401(k) participation, the automatic IRA approach holds considerable promise of expanding retirement saving for millions of workers.

This bipartisan, cross-ideological automatic IRA proposal put forward in your bill, H.R. 2167, has elicited favorable responses from across the political spectrum. As Congressional Budget Office Director Peter Orszag recently stated, “I do sense that there is significant bipartisan support for this kind of approach.”³² Indeed, support has come from both the Chair of the Council of Economic Advisers under President Clinton and the Chair of the Council of Economic Advisers under President Reagan, from the New York Times editorial page and the Washington Times’ chief political correspondent.³³

Similar types of proposals have been introduced by Senate Finance Committee Chairman Max Baucus and advanced by the Commission on the Regulation of U.S. Capital Markets in the 21st Century, an Independent Bipartisan Commission Established by the U.S. Chamber of Commerce, while the automatic IRA proposal itself has been supported or has been the subject of favorable comment by a variety of other groups and individuals including AARP, Marketwatch,

³² Presentation at the Retirement Security Project conference on “The Automatic Revolution” at the National Press Club, Washington, D.C., June 10, 2008.

³³ The former Chair of President Clinton’s Council of Economic Advisers, Laura Tyson, has stated that the “Automatic IRA would help to ensure that employees have enough retirement savings.” (Wall Street Journal, Oct. 30, 2007), and the former Chair of President Reagan’s Council of Economic Advisers, Professor Martin Feldstein, has said, “I am a great enthusiast of automatic enrollment IRAs. I think as a policy it’s a no-brainer. I think the legislation should be enacted. I can’t imagine why there would be any significant opposition from political players on either side of the aisle.” Presentation at the Retirement Security Project conference on “The Automatic Revolution” at the National Press Club, Washington, D.C., June 10, 2008.

The New York Times has stated, in an editorial, “The best idea yet developed for making savings universal is an I.R.A. that is funded with automatic direct deposits from a paycheck. . . . Congress should pass legislation to establish auto-I.R.A.’s, and the president should sign it.” (New York Times, editorial, March 18, 2006). The Washington Times’ chief political correspondent, Donald Lambro, has said, “The savings rate in our country . . . is abysmal. This [the Automatic IRA] would dramatically turn that rate around, helping millions to build wealth and some measure of retirement security.” (Washington Times, April 12, 2007.)

Newsday, Jane Bryant Quinn, and the 2006 National Summit on Retirement Savings.³⁴

Chairman Neal, Ranking Member English, and Members of the Subcommittee, we appreciate the opportunity to testify before the Subcommittee and would be happy to respond to any questions.

³⁴ See n. 3, above, and www.retirementsecurityproject.org.

J. Mark Iwry

Mark Iwry (pronounced "Eevry") is a Nonresident Senior Fellow at the Brookings Institution, a Principal of the Retirement Security Project, Research Professor at Georgetown University, and Of Counsel to the law firm of Sullivan & Cromwell LLP, where he specializes in pensions, compensation and benefits. He was Benefits Tax Counsel at the U.S. Treasury Department from 1995 to 2001, serving as the principal Executive Branch official directly responsible for tax policy and regulation relating to the Nation's qualified pension and 401(k) plans, employer-sponsored health plans, and other employee benefits.

Recently named one of the 100 Most Influential People in Finance (*Treasury and Risk Magazine*, June 2008), Mr. Iwry has often testified before congressional committees – formerly representing the Treasury and Executive Branch and, since leaving government, testifying as an independent expert – and State legislatures. He has advised numerous Senators and Members of Congress on both sides of the aisle, five Presidential campaigns (2004 and 2008), GAO, other federal agencies, State officials and legislators, foreign government agencies and officials (including the United Kingdom and Israel), AARP, and other private-sector organizations on retirement savings, and has served as an expert witness in federal litigation. He was formerly a partner in the law firm of Covington & Burling, chair of the D.C. Bar Employee Benefits Committee, and a member of the White House Task Force on Health Care Reform, and has addressed several hundred professional, industry, policy and academic conferences. Mr. Iwry co-edited the book, *"Aging Gracefully: Ideas to Improve Retirement Security in America"* (Century Fdn. Press, 2006) (with William Gale and Peter Orszag); the automatic IRA proposal he has co-authored through the Retirement Security Project has been introduced as a bill in Congress, and the proposals he has co-authored to leverage State resources to expand pension coverage have been introduced as bills in several States.

A principal architect of the Saver's Credit to expand 401(k) and IRA coverage (claimed annually on 5.3 million tax returns) and the "SIMPLE" 401(k)-type plan (covering an estimated 3 million workers), Mr. Iwry directed Treasury's formulation and implementation of an integrated strategy to increase retirement saving by defining, approving and promoting 401(k) automatic enrollment as well as automatic rollover to curtail pension leakage. He has also been centrally involved in initiating or orchestrating many other significant improvements and simplifications of the nation's pension and health care systems, including development of the Presidential "Universal Savings Accounts" proposal (1999-2000), and strengthening oversight of the PBGC by its Board of Directors.

While in government, Mr. Iwry was widely recognized for his work to expand coverage while simplifying and rationalizing benefits law and regulation. He received the Secretary of the Treasury's Exceptional Service Award "[i]n recognition of his outstanding leadership and accomplishments Widely respected as Treasury's benefits and pension expert, Mr. Iwry excelled at building coalitions of diverse interests...." At Treasury, he drew upon a wide spectrum of private sector advice, held town hall meetings around the country, and received a special IRS (Office of Chief Counsel) award "[i]n recognition of the collegial working relationship you have fostered between [Treasury] and the IRS Office of Chief Counsel and of your many contributions to our nation's tax system."

Mr. Iwry's views are often reported in the major media and trade press. He is an honors graduate of Harvard College and Harvard Law School, has a Masters in Public Policy from Harvard's Kennedy School of Government, is a member of the bar of the US Supreme Court, a Fellow of the American College of Employee Benefits Counsel, and is listed in *Who's Who*, *Best Lawyers in America*, *Washington, DC Super Lawyers*, etc.

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David John

David John, Principal to the Retirement Security Project and a Senior Research Fellow with the Thomas A. Roe Institute for Economic Policy Studies at the Heritage Foundation. He has been involved in Washington's top policy debates for almost 30 years and he continues that career as Heritage's lead analyst on issues relating to pensions, financial institutions, asset building, and Social Security reform. He has also commented on corporate governance and financial literacy.

John has written and lectured extensively on the importance of reforming the nation's retirement system. During this time, he has testified before a number of House and Senate committees on subjects ranging from Social Security and pension reform to improving the nation's flood insurance program. In 2001, he testified before the President's Commission to Strengthen Social Security, providing detailed analysis of how personal retirement accounts could be structured and regulated. John also testified before the House Budget Committee's Task Force on Social Security, explaining what the costs of transitioning to a system of Social Security personal retirement accounts might be as compared to the cost of running the current program.

In addition, John has testified before the House Ways and Means Committee on issues such as steps that should be taken to improve Social Security for women and minorities, how to increase the information that the public can receive about Social Security programs, and how the United Kingdom's pension system operates. He also testified before both the Senate Special Committee on Aging and the House Education and the Workforce Committee on proposals to strengthen the funding of defined benefit pension plans.

John has been published and quoted extensively in many major publications, including the Wall Street Journal, Financial Times, Washington Post, New York Times, Chicago Tribune, Los Angeles Times, Philadelphia Inquirer, Washington Times, Forbes, Business Week, and USA Today. He has also appeared on CBS News, NBC News, CNN, MSNBC, the Fox News Channel, BBC radio, and many other national and syndicated radio and television shows.

John came to The Heritage Foundation from the office of Rep. Mark Sanford, R-S.C. John was the lead author of Rep. Sanford's plan to reform Social Security by setting up a system of personal retirement accounts. John's Capitol Hill service also includes stints in the offices of Reps. Matt Rinaldo, R-N.J., and Rep. Doug Barnard Jr., D-Ga. While working for Barnard, John helped write one of the first bills that would have eliminated restrictions on banks to sell securities and insurance. He also authored a bill in 1981 that restarted the national commemorative coin program.

In the private sector, John was a Vice President specializing in public policy development at The Chase Manhattan Bank in New York. In addition, he worked for three years as Director of Legislative Affairs at the National Association of Federal Credit Unions, and worked as a senior legislative consultant for the Washington law firm of Manatt, Phelps & Phillips.

John earned a bachelor's degree in journalism, an MBA in finance, and a master's degrees in economics from the University of Georgia in Athens.

Chairman NEAL. Thank you for your testimony.
Mr. Salisbury.

**STATEMENT OF DALLAS SALISBURY, PRESIDENT AND CHIEF
EXECUTIVE OFFICER, EMPLOYEE BENEFIT RESEARCH IN-
STITUTE (EBRI)**

Mr. SALISBURY. Chairman Neal, Ranking Member English, and Members of the Committee, it's a pleasure to be here. I thank you for the invitation. I am Dallas Salisbury, president of the Employee Benefit Research Institute, and Chairman of the American Savings Education Council.

Since beginning our work at EBRI in 1978, we have published 317 issue briefs. The very first was on the topic of universal IRAs and deductible employee contributions. Personally, my first testimony on IRAs was before the Senate Finance Committee in 1981. They have developed since that time with IRAs now representing about 27 percent of total retirement system assets, total assets in that system approaching about \$18 trillion.

Employment-based defined contribution plans represent about 26 percent of assets, private ERISA-defined benefit plans about 17 percent, and public sector-defined benefit plans about 30 percent of those aggregate assets.

For 2005, the most recent year for which data is publicly available: about 10 percent of all taxpayers put money into an IRA, either directly or through a rollover; 5.3 million made deductible contributions totaling about \$16 billion; Roth IRAs, 6.7 million taxpayers, about \$18.6 billion; 2.5 percent of taxpayers rolled over funds totaling \$231.5 billion in that year; and a total of \$140 billion was withdrawn in IRAs during that year, to be spent on we're not sure what.

This compares to 14 percent of taxpayers who are active participants in ERISA-defined benefit plans to which \$94 billion was contributed, and 35 percent of taxpayers who were active participants in ERISA-defined contribution plans into which \$228 billion was contributed. Total benefit payments from those programs, both annuity and lump sums, totaled \$333 billion, of which \$215 billion was rolled over into Individual Retirement Accounts, thus underlining a point that Congressman Pomeroy was making in his earlier testimony: the critical role that employment-based programs make in the system, and the tenderness of making changes in other areas that might threaten those programs.

The GAO report points out the lack of success in encouraging IRA-based plan development among small employers. EBRI small employer surveys have found a lack of perceived employees demand for retirement plans, and higher pay and health insurance always are deemed to be more important by both small employers and their workers. Our value of benefits surveys have consistently found that over 85 percent of employees, when asked what they would like first, say health insurance. Only about 7 percent say a defined contribution savings opportunity.

All of these trends affect a second point, which is that over 42 percent of the work force still works for an employer that does not use automated payroll. EBRI has not surveyed employer attitudes toward automatic IRAs, per se, but did surveys on individual Social

Security account proposals. We found overall opposition among small employers, if they were being required to set up any arrangement with any financial institution.

Overwhelmingly, interestingly, they were in support of proposals that would allow them to send additional retirement contributions as part of payroll taxes to the government, suggesting there would be ways to structure universal or automatic IRAs that would be acceptable if the ideological issues could be overcome.

EBRI research on the administrative issues and individual Social Security accounts reinforces the fact that automatic IRA designs are possible, but they would take unique approaches not contained in current legislation in order to minimize administrative cost. Every test or handle included in these proposals adds complexity which small employers in our surveys find troubling. That is not to say it should not be done, but it does suggest a hurdle.

As GAO points out, there is a great deal we do not know about IRAs, as a result of limited data availability. Since 1995, the Employee Benefit Research Institute has built a database on 401(k) data, and effective this year we will begin adding detailed IRA data to that database. It would be helpful if the IRS would make more detailed data available on an ongoing basis so the public on both IRAs and 401(k)s to help us analyze proposals such as these.

I thank the Committee again for the invitation to testify, and would be pleased to respond to any questions.

[The prepared statement of Mr. Salisbury follows:]

**Statement of Dallas Salisbury, President and Chief Executive Officer,
Employee Benefit Research Institute (EBRI)**

Chairman Neal and members of the Subcommittee on Select Revenue Measures, thank you for your invitation to testify today on the role of individual retirement accounts, or IRAs, in our retirement system. I am Dallas Salisbury, president and CEO of the Employee Benefit Research Institute.

Since beginning our work in 1978, the Employee Benefit Research Institute has published 317 *EBRI Issue Briefs*.[®] The very first was on the subject of “Universal IRAs and Deductible Employee Contributions.” Since that time we have published data on IRAs on an ongoing basis. Chapter 15 of the *EBRI Databook on Employee Benefits* is on IRA participation and Chapter 16 is on *IRA Assets*.¹

Twenty-three percent of workers ages 21–64 owned an IRA at the end of 2005, an increase from 15.9 percent in 1996.² We know IRA ownership increases with family income and age: Among workers with annual family income of \$10,000–\$19,999, 8.3 percent owned an IRA, compared to 35.1 percent of those with family income above \$75,000. We also know education is a more striking indicator: 2.7 percent of those without a high school diploma have an IRA, compared to 46.5 percent of those with a graduate degree.

IRAs have become the largest single vehicle for retirement assets in the United States. Assets have continuously grown in IRAs as a function of new contributions (about \$49 billion in the most recent year for which data are available), but the asset growth is mostly due to rollover distributions from both employment-based defined benefit (pension) and defined contribution retirement plans such as 401(k)s (more than \$210 billion, according to the latest data).³ As a result, total IRA assets now exceed the assets in private-sector employment-based defined contribution plans: IRA assets reached \$4.75 trillion at year-end 2007, compared with \$3.49 tril-

¹ EBRI Databook of Employee Benefits, Chapter 15, Individual Retirement Account—Participation <http://www.ebri.org/pdf/publications/books/databook/DB.Chapter%2015.pdf> and EBRI Databook of Employee Benefits, Chapter 16, Individual Retirement Accounts and Keogh Assets <http://www.ebri.org/pdf/publications/books/databook/DB.Chapter%2016.pdf>

² Craig Copeland, “Ownership of Individual Retirement Accounts (IRAs) and 401(k)-Type Plans,” *EBRI Notes*, no. 5 (Employee Benefit Research Institute, May 2008): 2–12.

³ Victoria L. Bryant, “Accumulation and Distribution of Individual Retirement Arrangements, 2004,” *SOI Bulletin* (Spring 2008): 90–101.

lion in private-sector defined contribution plans.⁴ The Internal Revenue Service (IRS) reports that 7.9 million taxpayers age 65 or older withdrew money from an IRA in 2004, amounting to \$76.8 billion.⁵

Since IRAs have been increasingly important to Americans' retirement security, EBRI has focused a lot of its research on IRAs. For a 2001 NASI conference, EBRI simulated the projected increase in the IRAs importance in retirement wealth.⁶ At that time, we estimated an increase from 28 percent of retirement wealth for males born in 1936 to 40 percent for males born in 1964. Females were estimated to have an increase from 18 percent to 32 percent for the same birth cohorts. Since that time, the increased importance of 401(k) plans, and the likely plan design modifications that are likely to result from the passage of the Pension Protection Act (PPA) in 2006 will undoubtedly result in an even larger percentage of retirement wealth contained in IRAs.⁷

The values accumulated in IRAs would likely be even greater if all monies contributed and/or rolled over to these accounts were not available for pre-retirement withdrawals. Simulations from the EBRI/ICI 401(k) Accumulation Projection Model in 2002 showed that the income replacement rates that could be expected from a combination of 401(k) account balances and IRA rollovers that resulted from 401(k) contributions would increase between 11 and 18 percentage points (depending on salary level) if pre-retirement withdrawals were never taken from IRA balances.⁸

At the request of this Committee, the General Accountability Office undertook a review of individual retirement accounts that was published this month. The staff of the Employee Benefit Research Institute was pleased to cooperate with the GAO in their research.

The GAO report does a good job of setting out the current data on IRAs.

The report also points out the lack of success in encouraging plan development among small employers due to lack of resources, unsteady revenues, and lack of knowledge and/or misconceptions in how plans operate.

Small employer surveys undertaken by EBRI in the past also pointed out the lack of employee demand for the retirement plans, where higher pay and/or health insurance was deemed to be more important in the view of employers.⁹ EBRI Value of Benefits surveys over the past 25 years have consistently found that workers put health insurance first,¹⁰ and our most recent EBRI Health Confidence Surveys have found that over a third of workers have reduced their retirement savings due to rising health care costs.¹¹ All of these trends affect plans with payroll deduction in general, and programs like non-employer-based IRAs (where automatic deductions have not been arranged).

The GAO has pointed out the lack of information on the use of payroll deduction IRAs (or those that allow a direct debit from a savings or checking account). GAO does not discuss this topic on IRAs, but the data is lacking regardless. This is another manner to get workers' dollars into an IRA before the individual can spend it.

The GAO report suggests tax credits to employers (on p. 29) to increase the adoption of payroll deduction IRAs. Congress will need to consider the fact that tax credits to employers for starting these plans have proven to be ineffective. The EBRI Small Employer Surveys found that small employers do not understand the tax laws surrounding plans.

EBRI Small Employer Surveys also have found overall opposition to proposals that small employers be required to set up arrangements with financial institutions. However, there is support among small employers for sending additional retirement

⁴ Board of Governors of the Federal Reserve, *Flow of Funds Accounts of the United States: Flows and Outstandings: First Quarter 2008*. June 5, 2008

⁵ Bryant, op cited.

⁶ Jack VanDerhei and Craig Copeland, (2002). *The Future of Retirement Income: The Changing Face of Private Retirement Plans* (pp. 121–147). National Academy of Social Insurance: The Future of Social Insurance: Incremental Action or Fundamental Reform.

⁷ Jack VanDerhei and Craig Copeland, The Impact of PPA on Retirement Income for 401(k) Participants, EBRI Issue Brief, No. 318, June 2008

⁸ Sarah Holden and Jack VanDerhei, Can 401(k) Accumulations Generate Significant Income for Future Retirees? EBRI Issue Brief and ICI Perspective, October 2002. This is a first-order approximation and does not take into account changes in participant behavior that might occur as a result of changing the pre-retirement access to this money.

⁹ Employee Benefit Research Institute, *Small Employer Retirement Survey Results*. <http://www.ebri.org/surveys/sers/>.

¹⁰ The latest Value of Benefits Survey results can be found in Rachael Christensen, "Value of Benefits Constant in a Changing World: Findings from the 2001 EBRI/MGA Value of Benefits Survey." *EBRI Notes*, no. 3 (Employee Benefit Research Institute, March 2003): 1–3.

¹¹ Employee Benefit Research Institute, *Health Confidence Survey Results* www.ebri.org/surveys/hcs/

contributions as part of their existing payroll tax deposits and letting the government deal with all of the administrative issues.

This suggests that proposals like those discussed in the GAO report for “automatic IRAs” for some segment of the population (most proposals would not apply to about 25 million workers in very small firms) would need to be carefully designed in order to prove successful. In fact, research conducted by EBRI on the administrative issues in individual Social Security accounts¹² suggests ways in which an “automatic IRA” could be made available to all workers, were accessibility and accumulation the primary objectives. It could be done with lower administrative expense and lower business burden than proposals that are more limited in their scope, but rely on payroll deduction. This is the case because of the significant portion of the workforce that is not paid through automated and linked payroll systems.

Working through our American Savings Education Council and our ChooetoSave.org® programs, and based upon our 18 years of Retirement Confidence Surveys,® EBRI has found that individuals need to become convinced of the need to save for the future before they will (a) do it, and (b) preserve the funds upon job change. While \$214.9 billion was rolled into IRAs in 2004, most workers that receive distributions of less than \$20,000 do not roll over their entire distributions, and cash out at least some portion of their retirement savings.¹³

As GAO points out, there is a great deal we do not know about IRAs as a result of limited data reporting. Since 1995, EBRI has been working with the Investment Company Institute and administrative firms to build a large database on 401(k) plans that has begun to allow many questions to be answered about the role of those plans in our retirement system. This year we are starting to build a companion database of IRA data that will begin to fill many of the gaps in information identified by the GAO report.

As GAO notes, the IRS does collect a significant amount of IRA information. Were that information more widely available in a timely fashion, it would be of great assistance to both the public and the private sectors. For example, the Census Bureau’s Current Population Survey reports that very few of those over age 55 and 65 report income from IRAs, Keoghs or 401(k) plans. Yet, the IRS tax records recorded \$140 billion in payments out of IRAs alone in 2004. The Federal Reserve’s Survey of Consumer Finance, and the HHS Health and Retirement Survey, also under-report income from these programs, when it is possible to compare individual self-response with “administrative” records like tax returns. A major issue for the nation revolves around the financial status of those near or in retirement, and the availability of IRS administrative records could make a significant contribution to policy-making. We hope that the IRA administrative records database being developed by EBRI will do so as well.

As the GAO report underlines, the primary role of IRAs in our retirement system today is to provide a tax-deferred account for the retirement assets of those who have left an employer-sponsored defined benefit (pension) or defined contribution (401(k)-type) plan. Rollovers amounted to \$214.9 billion in 2004, compared to \$48.7 billion in contributions.

The goal that ERISA set for IRAs in 1974 as a way for **all of those outside of an employer based plan** to save for retirement **has not been realized**. This underlines the central role played by both Social Security and employer-sponsored plans in Americans’ future retirement security.

I thank the Committee again for the invitation to testify.

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¹³ Craig Copeland, “Lump Sum Distributions,” *EBRI Notes*, no. 12 (Employee Benefit Research Institute, December 2005): 7–17.

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Chairman NEAL. Thank you.
Mr. Eisenbrey.

**STATEMENT OF ROSS EISENBREY, VICE PRESIDENT,
ECONOMIC POLICY INSTITUTE**

Mr. EISENBREY. Thank you, Mr. Neal. It's a pleasure to be here, and an honor.

Proposals like the automatic IRA cannot hurt. The problem is that they probably won't help much, either. This is because such proposals don't make 401(k)'s or IRAs a better deal for ordinary workers. They make it physically easier for them to put money into an account, but not financially easier.

The shift from traditional pensions which are truly automatic, in the sense that they automatically create retirement savings, to IRAs, 401(k)'s, and other individual savings accounts that require workers to shoulder most or all of the cost and risk, has left most workers with less retirement security. It is not enough simply to argue that the shift from traditional pensions to individual accounts is a reflection of market forces. The tax incentives Congress provides for retirement accounts are not a result of market forces. They are a political decision, and they constitute an enormous subsidy from the Federal Government that has done almost nothing to increase retirement savings.

There are three big problems with these tax incentives, which automatic IRAs would not change: first, only households that owe income tax are eligible for the subsidies, the size of which also depends on a household's tax bracket; second, even if the value of the tax deduction per dollar saved didn't vary by income level, high-income households have more disposable income to set aside, so subsidies would still disproportionately benefit them; and finally, the

incentive effect is weak, or non-existent, since there is no way to ensure that these tax incentives encourage new saving.

The present value of tax expenditures for 401(k) and IRA contributions in 2007 amounted to nearly \$135 billion. Roughly 70 percent of these subsidies go to the top 20 percent of the income distribution, and almost half go to the top 10 percent. The average worker gets little help from this \$135 billion, due to an upside down incentive structure that gives a wealthy family in a 35 percent tax bracket a tax break 3.5 times more valuable than a family in a 10 percent tax bracket, even if each family contributes the same dollar amount to a tax-favored account.

In other words, those who need the help least to save get the most help. Thus, it is not surprising that only 3 out of 10 households received a tax break for contributing to a defined contribution plan or IRA in 2004. Congress, starting with this Committee, has tilted the subsidy table toward the better off, and told most Americans, "You're on your own."

These tax breaks are not just unfair, they're ineffective, because they mostly cause wealthy households to shift savings to tax-favored accounts, rather than increasing overall savings. Thus, the paradox: the taxpayers are giving up more and more revenue to promote retirement savings while retirement security declines, along with the national savings rate. Tax incentives ought to do more than lower the taxes paid by wealthy households. They ought to help all workers save for retirement.

The implicit assumption behind the auto-IRA approach is that the problem lies with the worker, not with the retirement options she faces. But even in the best case scenario, a participant who contributes regularly and does not touch her savings until retirement, high fees may erode a quarter or more of her nest egg, compared to savings pooled in a cost-efficient pension fund.

These problems are compounded by the problem that individual investors feel torn between low fixed returns and gambling with their nest egg. Finally, even a worker who saves steadily and has good luck with investments may outlive her savings.

So, these problems require the kind of creativity that you called for in your opening statement, Mr. Neal. I think we need to think outside the box that we have been in, and we would like to propose—and I have brought, and would like to offer for the record, a plan called The Guaranteed Retirement Account. Could I submit that for the record?

Chairman NEAL. You certainly can.

Mr. EISENBREY. Thank you.

[The information follows:]

Statement of Ross Eisenbrey, Vice President, Economic Policy Institute
 Testimony before the Subcommittee on Select Revenue Measures
 of the House Committee on Ways and Means
 Thursday, June 26, 2008

Chairman Neal, Ranking Member English, and distinguished members of the Subcommittee, I appreciate the opportunity to appear before you today to discuss ways to expand retirement security. The opinions I will express are my own and not necessarily those of the Economic Policy Institute.

Before I begin, I would like to clarify that the issues I plan to address are relevant to all types of individual savings accounts, not just IRAs. The distinction between IRAs and defined-contribution plans is often immaterial, because most funds in IRAs were rolled over from defined-contribution plans, and some IRAs, like SIMPLE IRAs, are very similar to defined-contribution plans.

In recent years, the focus of retirement experts and policymakers has been on proposals to increase retirement savings through payroll deductions into savings accounts like IRAs or 401(k)s. The latest such proposal is the Automatic IRA Act, which has been introduced with bipartisan support in both houses of Congress.

These proposals are designed to overcome behavioral obstacles to participating and contributing to retirement accounts—by, for example, requiring workers to opt out of a plan rather than opting in. The Automatic IRA Act, for example, would require any employer with more than 10 employees who does not have a retirement plan to offer automatic deduction to an IRA.

The consensus is that this approach cannot hurt. The problem is that it will not help much either. This is because these proposals do not make 401(k)s or IRAs a better deal for ordinary workers, they just make it easier for them to put money into an account.

These proposals are a distraction from the real problem, which is that most workers have not been well served by the shift from traditional pensions, which are truly automatic, to IRAs, 401(k)s and other individual savings accounts that not only require workers to sign up for an account, but also shoulder most or all of the cost and the risk.

One might argue that the shift from traditional pensions to one of individual accounts is simply a reflection of market forces. But tax incentives for savings accounts represent an enormous subsidy from the federal government, with little to show for it.

There are three big problems with these supposed incentives, which Automatic IRAs would do little to change. First, only households that owe income tax are eligible for the subsidies, the size of which also depend on the household's tax bracket.¹ Even if that were not the case, high-

¹ The Saver's Credit is designed to address this problem, but most people with incomes low enough to qualify cannot take advantage of it because they do not owe income tax and the credit is non-refundable (William G. Gale, J. Mark Ivey, and Peter R. Orszag, "Making the Tax System Work for Low-Income Savers: The Saver's Credit," Urban-Brookings Tax Policy Center *Issues and Options*, July 2005).

income households have more disposable income to set aside, so subsidies would still disproportionately benefit them. Finally, the incentive effect is weak or non-existent, since there is no way to ensure that tax incentives encourage new saving.

The present value of tax expenditures for 401(k) and IRA contributions in 2007 amounted to nearly \$135 billion.² According to the Urban-Brookings Tax Policy Center, roughly 70% of these subsidies go to those in the top 20% of the income distribution, and almost half go to the top 10%.³

These tax breaks are not just unfair, they are ineffective, because they mostly cause wealthy households to shift savings to tax-favored accounts rather than increase overall savings—thus the paradox that taxpayers are giving up more and more revenue to promote retirement savings while retirement security declines.

Tax incentives are supposed to do more than lower the taxes paid by wealthy households. They are supposed to help workers save for retirement. Yet enrollment in employer-based retirement plans has remained stagnant at around 50% of full-time workers. Due to inadequate contributions, cash-outs and other leakages, Federal Reserve data shows that the median 401(k) and IRA account balance of workers approaching retirement was \$60,000 in 2004, not even enough to buy a \$400 per month annuity.⁴

The implicit assumption behind the “Auto IRA” (and “Auto 401(k)”) approach is that the problem lies with the worker, not with the retirement options she faces. But even in the best-case scenario—a participant who contributes regularly and does not touch the savings until retirement—high fees may erode a quarter or more of her nest egg compared to savings pooled in a cost-efficient pension fund.

Meanwhile, the worker is likely to be getting little help from the federal government, due to an upside-down incentive structure that gives a wealthy family in a 35% tax bracket a tax break three and a half times more valuable than a family in a 10% tax bracket, even if each family contributes the same dollar amount to a tax-favored account. In other words, those who need the least help saving get the most. Thus it is not surprising that only about three out of ten households received a tax break for contributing to a defined contribution plan or IRA in 2004.⁵

These problems are compounded by the problem that individual investors feel they must choose between low, fixed returns and gambling with their nest egg. Retirement experts often bemoan the tendency of many 401(k) participants to invest in money market funds, but it is hard to argue against conservative investments when you consider that bear markets can last for a decade or longer. Other people, of course, take the opposite approach, investing all their retirement savings in risky stocks in a desperate attempt to catch up. In contrast, traditional pension funds invest in

² Office of Management and Budget, *Analytical Perspectives*, FY 2009 Budget, Table 19-4.

³ Leonard E. Burman, William G. Gale, Matthew Hall, and Peter R. Orszag, “Distributional Effects of Defined Contribution Plans and Individual Retirement Accounts,” Urban-Brookings Tax Policy Center, 2004.

⁴ Survey of Consumer Finances, as cited in Alicia H. Munnell and Annika Sundén, “401(K) Plans Are Still Coming Up Short,” Center for Retirement Research Issue Brief, March 2006.

⁵ Burman et al., 2004.

diversified portfolios and pool the savings of people who retire at different times, smoothing investment returns across generations.

Incidentally, the decision-making problem is not limited to those with little formal education. *Los Angeles Times* reporter Peter Gosselin found several Nobel Prize-winning economists willing to admit that they could not decide how to allocate their retirement savings.⁶

Finally, even a worker who saves steadily and has good luck with investments may outlive his or her savings. Theoretically, individuals can insure themselves against longevity risk by purchasing life annuities, but an adverse selection problem makes annuities expensive on the individual market, and people are often stymied by the difficulty of choosing among investment products.

Some of these problems can and should be fixed. Congress has begun to address the issue of hidden 401(k) fees, for example. But there are inherent advantages to traditional pensions, because pooling allows employers or the government to insure workers against most financial and longevity risks while taking advantage of economies of scale. Thus, the shift from traditional pensions to individual accounts has increased administrative costs while saddling workers with risk that would be easy to insure against in a group plan.

In other words, closing the retirement gap is not simply a question of increasing contributions, but also ensuring that benefits are broadly shared and retirement savings and income are secure.

We need a whole new approach. We need to replace IRAs and 401(k)s with something better. And though traditional pensions work well for large, stable employers, others are not in a position to take on long-term pension liabilities.

Last year, the Economic Policy Institute asked retirement expert Teresa Ghilarducci—who unfortunately could not be here today—to come up with a replacement for the current system of individual accounts. The resulting Guaranteed Retirement Account plan⁷ is a hybrid that combines the best features of defined-benefit and defined-contribution plans, including steady and predictable employer and employee contributions, low administrative costs, and guaranteed lifetime benefits.

The GRA plan would reapportion federal subsidies, which now disproportionately go to high-income families, while insuring participants against financial and longevity risk. It would start by converting tax expenditures for defined-contribution plans and IRAs into flat refundable credits. A Tax Policy Center analysis of the GRA plan found that this by itself would make 58% of taxpayers better off and only 16% of taxpayers worse off, most of them in the top income quintile. And unlike high-income households, low- and middle-income households would not fully offset this increase in savings with dis-saving in other forms.

⁶ Peter G. Gosselin, "Experts Are at a Loss on Investing," *Los Angeles Times*, May 11, 2005.

⁷ Teresa Ghilarducci, "Guaranteed Retirement Accounts: Toward retirement income security," EPI Briefing Paper, November 20, 2007. <http://www.sharedprosperity.org/wp204/p204.pdf>

Unlike "Auto IRA" and "Auto 401(k)" plans that focus on increasing voluntary contributions to savings accounts, the GRA plan squarely addresses the issue of adequacy through mandatory contributions, efficiency gains, and plugging cash-outs and other leaks. Like "pay or play" healthcare plans, the plan calls for all workers not enrolled in an equivalent or better pension plan to enroll in a Guaranteed Retirement Account. Contributions equal to 5% of earnings up to the Social Security earnings cap would be deducted along with payroll taxes and credited to individual accounts, though the funds would be pooled and invested together.

The cost of these contributions would be split equally between employers and employees. However, employee contributions would be offset in whole or in part through an inflation-indexed \$600 refundable tax credit that would take the place of tax breaks for defined-contribution accounts and IRAs.

GRA accounts would be administered by the Social Security Administration, and the funds managed by the Thrift Savings Plan or similar body, which in turn would outsource investment functions to an outside provider. Though the funds would be invested in financial markets, participants would earn a fixed 3% rate of return adjusted for inflation and guaranteed by the federal government. If the trustees determined that actual investment returns were consistently higher than 3% over a number of years, the surplus would be distributed to participants, though a balancing fund would be maintained to ride out periods of low returns.

Workers would be able to track the dollar value of their accumulations, the same as with 401(k)s and IRAs. However, account balances would be converted to inflation-indexed annuities upon retirement to ensure that workers would not outlive their savings.

The result is that participants would be guaranteed a secure retirement after a lifetime of contributions. A prototypical worker could expect a benefit equal to roughly 25% of pre-retirement income after 40 years. Since Social Security provides such a worker with a benefit equal to roughly 45% of pre-retirement income at age 65, the total replacement rate would be approximately 70% of pre-retirement income, which is considered the minimum necessary to avoid a drop in living standards upon retirement.

The GRA plan gives voters what they want—a simple, fair and effective way to save for retirement. According to the Rockefeller Foundation's American Worker Survey, Americans are equally concerned about having access to health care and pension benefits, and they are about three times more likely to want a job that guarantees health coverage and a pension rather than one that pays more.

Americans are seeking financial security after flirting with day trading, stock options, and house flipping. Quasi-free market solutions relying on inequitable and ineffective tax breaks have lost much of their appeal. Instead of tax breaks for a lucky few, the government would be telling all workers, "we'll throw in the first \$600, and the rest is up to you and your employer."

Admittedly, Americans remain leery of government solutions and convinced that retirement is unaffordable. The GRA plan addresses these concerns through advance funding, shared employer-employee contributions, and a revenue-neutral reallocation of government subsidies.

Thus, it is important to emphasize that the GRA plan would not increase the federal deficit and would reinforce the link between work and retirement benefits, encouraging people to work longer.

Current economic conditions highlight the need for a new plan. In contrast to Social Security and defined benefit pension plans, individual accounts like 401(k)s and IRAs are not insulated from the effects of economic downturns, since asset markets tend to move pro-cyclically. In a recession, participants are often forced to delay retirement, which has a spillover effect on unemployed workers as vacancies shrink. A recession is also likely to reduce contributions and increase leakages, and some fund managers have already reported an increase in hardship withdrawals and loans.

The role of housing as a conduit to savings and financial security has eroded as the housing market has slumped and homes have been transformed into speculative investments or collateral for loans. Even ignoring the immediate problems associated with sub-prime loans and foreclosures, two long-term trends – increased mobility and home equity withdrawals – point to a greater need for more leak-proof and secure savings vehicle than housing, which represented nearly 40 percent of total assets held by households, according to the last Survey of Consumer Finances conducted by the Federal Reserve. (That figure may, of course, be somewhat lower today.)

I would like to say that if Automatic IRAs are the answer, you are asking the wrong question. The question should not be, “how can we make a bad system a little better,” but rather, “how can we make sure Americans have adequate and secure retirement incomes after a lifetime of work?” The answer, I think, is the Guaranteed Retirement Account plan.

Before I conclude, I should add that one of our state affiliates—the Economic Opportunity Institute in Washington State—has come up with an Automatic IRA plan that would be administered by a state agency.⁸ The Institute has worked closely with Mark Iwry and other architects of the Automatic IRA approach.

However, the Washington State plan would do more to protect workers than the current federal legislation. Besides expanding coverage, the plan would keep costs down by, among other things, using an existing administrative structure, pooling funds to take advantage of economies of scale, and negotiating fees with providers.

The plan is a step in the right direction, but because it is designed to work within the existing federal framework, it cannot correct the failures of this system, such as the fact that IRAs currently function more as tax shelters for the wealthy than retirement vehicles for the rest of us.

⁸ Information about Universal Voluntary Retirement Accounts is available at the EOI website at http://www.eoionline.org/washington_voluntary_accounts/voluntary_accounts.html

Mr. EISENBREY. It is a plan that was produced for the Economic Policy Institute by Teresa Ghilarducci, a retirement expert. It's a hybrid that combines the best features of defined benefit and defined contribution plans, including steady and predictable employer and employee contributions, low administrative costs, 100 percent portability, and guaranteed lifetime benefits.

The GRA plan would deliver Federal subsidies to the families who really need them, while insuring participants against financial and longevity risk. It starts by converting tax expenditures for defined contribution plans into refundable, flat tax credits. A tax policy center analysis of the GRA plan found that this, by itself, would make 58 percent of taxpayers better off, and only 16 percent of mostly high-income taxpayers worse off.

Unlike auto-IRA plans that focus on increasing voluntary contributions, the GRA plan squarely addresses the issue of adequacy through mandatory contributions, efficiency gains, and plugging cash-outs and other leaks.

Workers not enrolled in an equivalent or better pension plan would be enrolled in a GRA account, contributions equal to 5 percent of earnings, up to the Social Security earnings cap, could be deducted, along with payroll taxes, and credited to individual accounts, though the funds would be pooled and invested together.

I see I am over my limit. I will stop. But we would love to present this plan in greater detail.

[The prepared statement of Mr. Eisenbrey follows:]

Statement of Ross Eisenbrey, Vice President, Economic Policy Institute

Chairman Neal, Ranking Member English, and distinguished members of the Subcommittee, I appreciate the opportunity to appear before you today to discuss ways to expand retirement security. The opinions I will express are my own and not necessarily those of the Economic Policy Institute.

Before I begin, I would like to clarify that the issues I plan to address are relevant to all types of individual savings accounts, not just IRAs. The distinction between IRAs and defined-contribution plans is often immaterial, because most funds in IRAs were rolled over from defined-contribution plans, and some IRAs, like SIMPLE IRAs, are very similar to defined-contribution plans.

In recent years, the focus of retirement experts and policymakers has been on proposals to increase retirement savings through payroll deductions into savings accounts like IRAs or 401(k)s. The latest such proposal is the Automatic IRA Act, which has been introduced with bipartisan support in both houses of Congress.

These proposals are designed to overcome behavioral obstacles to participating and contributing to retirement accounts—by, for example, requiring workers to opt out of a plan rather than opting in. The Automatic IRA Act, for example, would require any employer with more than 10 employees who does not have a retirement plan to offer automatic deduction to an IRA.

The consensus is that this approach cannot hurt. The problem is that it will not help much either. This is because these proposals do not make 401(k)s or IRAs a better deal for ordinary workers, they just make it easier for them to put money into an account.

These proposals are a distraction from the real problem, which is that most workers have not been well served by the shift from traditional pensions, which are truly automatic, to IRAs, 401(k)s and other individual savings accounts that not only require workers to sign up for an account, but also shoulder most or all of the cost and the risk.

One might argue that the shift from traditional pensions to individual accounts is simply a reflection of market forces. But tax incentives for savings accounts represent an enormous subsidy from the Federal Government, with little to show for it.

There are three big problems with these supposed incentives, which Automatic IRAs would do little to change. First, only households that owe income tax are eligi-

ble for the subsidies, the size of which also depends on the household's tax bracket.¹ Even if that were not the case, high-income households have more disposable income to set aside, so subsidies would still disproportionately benefit them. Finally, the incentive effect is weak or non-existent, since there is no way to ensure that tax incentives encourage new saving.

The present value of tax expenditures for 401(k) and IRA contributions in 2007 amounted to nearly \$135 billion.² According to the Urban-Brookings Tax Policy Center, roughly 70% of these subsidies go to those in the top 20% of the income distribution, and almost half go to the top 10%.³

These tax breaks are not just unfair, they are ineffective, because they mostly cause wealthy households to shift savings to tax-favored accounts rather than increase overall savings—thus the paradox that taxpayers are giving up more and more revenue to promote retirement savings while retirement security declines.

Tax incentives are supposed to do more than lower the taxes paid by wealthy households. They are supposed to help workers save for retirement. Yet enrollment in employer-based retirement plans has remained stagnant at around 50% of full-time workers. Due to inadequate contributions, cash-outs and other leakages, Federal Reserve data show that the median 401(k) and IRA account balance of workers approaching retirement was \$60,000 in 2004, not even enough to buy a \$400 per month annuity.⁴

The implicit assumption behind the “Auto IRA” (and “Auto 401(k)”) approach is that the problem lies with the worker, not with the retirement options she faces. But even in the best-case scenario—a participant who contributes regularly and does not touch the savings until retirement—high fees may erode a quarter or more of her nest egg compared to savings pooled in a cost-efficient pension fund.

Meanwhile, the worker is likely to be getting little help from the Federal Government, due to an upside-down incentive structure that gives a wealthy family in a 35% tax bracket a tax break three and a half times more valuable than a family in a 10% tax bracket, even if each family contributes the same dollar amount to a tax-favored account. In other words, those who need the least help saving get the most. Thus it is not surprising that only about three out of ten households received a tax break for contributing to a defined contribution plan or IRA in 2004.⁵

These problems are compounded by the problem that individual investors feel they must choose between low, fixed returns and gambling with their nest egg. Retirement experts often bemoan the tendency of many 401(k) participants to invest in money market funds, but it is hard to argue against conservative investments when you consider that bear markets can last for a decade or longer. Other people, of course, take the opposite approach, investing all their retirement savings in risky stocks in a desperate attempt to catch up. In contrast, traditional pension funds invest in diversified portfolios and pool the savings of people who retire at different times, smoothing investment returns across generations.

Incidentally, the decision-making problem is not limited to those with little formal education. *Los Angeles Times* reporter Peter Gosselin found several Nobel Prize-winning economists willing to admit that they could not decide how to allocate their retirement savings.⁶

Finally, even a worker who saves steadily and has good luck with investments may outlive his or her savings. Theoretically, individuals can insure themselves against longevity risk by purchasing life annuities, but an adverse selection problem makes annuities expensive on the individual market, and people are often stymied by the difficulty of choosing among investment products.

Some of these problems can and should be fixed. Congress has begun to address the issue of hidden 401(k) fees, for example. But there are inherent advantages to traditional pensions, because pooling allows employers or the government to insure workers against most financial and longevity risks while taking advantage of economies of scale. Thus, the shift from traditional pensions to individual accounts has

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increased administrative costs while saddling workers with risk that would be easy to insure against in a group plan.

In other words, closing the retirement gap is not simply a question of increasing contributions, but also ensuring that benefits are broadly shared and retirement savings and income are secure.

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Last year, the Economic Policy Institute asked retirement expert Teresa Ghilarducci—who unfortunately could not be here today—to come up with a replacement for the current system of individual accounts. The resulting Guaranteed Retirement Account plan⁷ is a hybrid that combines the best features of defined-benefit and defined-contribution plans, including steady and predictable employer and employee contributions, low administrative costs, and guaranteed lifetime benefits.

The GRA plan would reapportion Federal subsidies, which now disproportionately go to high-income families, while insuring participants against financial and longevity risk. It would start by converting tax expenditures for defined-contribution plans and IRAs into flat refundable credits. A Tax Policy Center analysis of the GRA plan found that this by itself would make 58% of taxpayers better off and only 16% of taxpayers worse off, most of them in the top income quintile. And unlike high-income households, low- and middle-income households would not fully offset this increase in savings with dis-saving in other forms.

Unlike “Auto IRA” and “Auto 401(k)” plans that focus on increasing *voluntary* contributions to savings accounts, the GRA plan squarely addresses the issue of adequacy through mandatory contributions, efficiency gains, and plugging cash-outs and other leaks. Like “pay or play” healthcare plans, the plan calls for all workers not enrolled in an equivalent or better pension plan to enroll in a Guaranteed Retirement Account. Contributions equal to 5% of earnings up to the Social Security earnings cap would be deducted along with payroll taxes and credited to individual accounts, though the funds would be pooled and invested together.

The cost of these contributions would be split equally between employers and employees. However, employee contributions would be offset in whole or in part through an inflation-indexed \$600 refundable tax credit that would take the place of tax breaks for defined-contribution accounts and IRAs.

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Workers would be able to track the dollar value of their accumulations, the same as with 401(k)s and IRAs. However, account balances would be converted to inflation-indexed annuities upon retirement to ensure that workers would not outlive their savings.

The result is that participants would be guaranteed a secure retirement after a lifetime of contributions. A prototypical worker could expect a benefit equal to roughly 25% of pre-retirement income after 40 years. Since Social Security provides such a worker with a benefit equal to roughly 45% of pre-retirement income at age 65, the total replacement rate would be approximately 70% of pre-retirement income, which is considered the minimum necessary to avoid a drop in living standards upon retirement.

The GRA plan gives workers what they want—a simple, fair and effective way to save for retirement. According to the Rockefeller Foundation’s American Worker Survey, Americans are equally concerned about having access to health care and pension benefits, and they are about three times more likely to want a job that guarantees health coverage and a pension rather than one that pays more.

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vance funding, shared employer-employee contributions, and a revenue-neutral reallocation of government subsidies. Thus, it is important to emphasize that the GRA plan would not increase the Federal deficit and would reinforce the link between work and retirement benefits, encouraging people to work longer.

Current economic conditions highlight the need for a new plan. In contrast to Social Security and defined benefit pension plans, individual accounts like 401(k)s and IRAs are not insulated from the effects of economic downturns, since asset markets tend to move pro-cyclically. In a recession, participants are often forced to delay retirement, which has a spillover effect on unemployed workers as vacancies shrink. A recession is also likely to reduce contributions and increase leakages, and some fund managers have already reported an increase in hardship withdrawals and loans.

The role of housing as a conduit to savings and financial security has eroded as the housing market has slumped and homes have been transformed into speculative investments or collateral for loans. Even ignoring the immediate problems associated with sub-prime loans and foreclosures, two long-term trends—increased mobility and home equity withdrawals—point to a greater need for more leak-proof and secure savings vehicle than housing, which represented nearly 40 percent of total assets held by households, according to the last Survey of Consumer Finances conducted by the Federal Reserve. (That figure may, of course, be somewhat lower today.)

I would like to say that if Automatic IRAs are the answer, you are asking the wrong question. The question should not be, “how can we make a bad system a little better,” but rather, “how can we make sure Americans have adequate and secure retirement incomes after a lifetime of work?” The answer, I think, is the Guaranteed Retirement Account plan.

Before I conclude, I should add that one of our state affiliates—the Economic Opportunity Institute in Washington State—has come up with an Automatic IRA plan that would be administered by a state agency.⁸ The Institute has worked closely with Mark Iwry and other architects of the Automatic IRA approach.

However, the Washington State plan would do more to protect workers than the current Federal legislation. Besides expanding coverage, the plan would keep costs down by, among other things, using an existing administrative structure, pooling funds to take advantage of economies of scale, and negotiating fees with providers.

The plan is a step in the right direction, but because it is designed to work within the existing Federal framework, it cannot correct the failures of this system, such as the fact that IRAs currently function more as tax shelters for the wealthy than retirement vehicles for the rest of us.

Chairman NEAL. I am delighted to accept it.

Mr. EISENBREY. Thank you.

Chairman NEAL. Mr. Hardock?

**STATEMENT OF RANDOLF HARDOCK, DAVIS & HARMAN, ON
BEHALF OF THE SAVINGS COALITION OF AMERICA**

Mr. HARDOCK. Thank you, Chairman NEAL. I am pleased to be here today on behalf of the Savings Coalition of America, a non-profit organization that promotes efforts to increase personal savings.

For many years, the Savings Coalition has been a strong advocate for improving and expanding IRAs. Chairman Neal, over the years, you have been doing that, doing a great job at that also. So, we urge you to continue those efforts to further improve IRA access.

The GAO earlier today expressed concern that many Americans who didn't have retirement plans at work are not saving enough for retirement. We agree completely. We need to reach more people by getting more employers to provide access to IRAs through pay-

⁸Information about Universal Voluntary Retirement Accounts is available at the EOI website at http://www.eoionline.org/washington_voluntary_accounts/voluntary_accounts.html

roll deduction mechanisms that have been proven effective in the 401(k), 403(b), and 457 plan models.

The best way to succeed in encouraging more small businesses to provide IRA opportunities for their workers is to give them understandable, low-cost, low-risk alternatives. The creation of the SIMPLE IRA was a major step in that direction. The use of the SIMPLE IRA continues to grow.

Just yesterday, the Investment Company Institute released data that showed that 2.2 million individuals participated in over 500,000 SIMPLE IRA mutual fund plans in 2007. The important statistic there is the continuous and steady growth in the adoption of SIMPLE IRAs since 1998, with a 10-percent increase in participation just last year.

So, the growth of SIMPLE IRAs has been something that is actually pretty impressive, but there is still much, much more to be done, as the other witnesses have said. We need to find ways to give people access to retirement saving in the workplace. Our members say that the reasons that doesn't happen—while there are many, there are four major reasons: cost, potential employer liability, the absence of incentives for small business decisionmakers, and the lack of employer education.

We suggest four changes that we believe would enhance the availability of IRAs in the workplace. First, we need to give employers comfort that they will not be exposed to costs, administrative burdens, and potential liability if they set up an IRA savings program at work. Many employers simply will not establish payroll deduction IRAs if they even think they could become subject to the full range of rules and regulations under ERISA.

The Labor Department has published helpful safe harbor comfort for employers, and we believe that needs to be expanded to clarify that employers can actively promote the idea of IRA savings in the workplace.

Employers should also be allowed to automatically default employees into a payroll deduction contribution, unless the employee affirmatively elects not to do so. Chairman Neal, Mr. English, your legislation to promote those kinds of defaults is something we hope to work with you further on.

The second major change we recommend is making SIMPLE IRAs even simpler, as proposed by Representative Kind, along with Representative Hulshof and Representative English in H.R. 5160.

Changes that would improve SIMPLE IRAs include: allowing small employers to move mid-year from a SIMPLE IRA to another kind of retirement plan; eliminating the restrictions on rollovers from SIMPLE IRAs into other retirement plans; and conforming the unique complex penalty tax provisions on premature distributions from SIMPLE IRAs to the same rules that apply across the board.

The third type of change that we recommend involves creating incentives for small business decisionmakers. Right now, small business employers have no tax incentives to make IRAs available to their employees. Representative Kind's bill, your bill, Mr. Neal, would encourage employers with a startup credit for new plans, and would allow small, one-time tax credits for each employee that actually signs up.

We also note that the complex IRA income eligibility limits discourage IRA participation across the board. They have for years. Without those complex limits, we would see increased savings among all income classes, and we would see many more small businesses deciding to set up IRAs for their employees.

Finally, we have to do a better job of educating small employers. We believe the IRS and the Small Business Administration can provide better information and education to small employers about providing IRA savings alternatives. At the same time, the IRS should be providing additional information on the availability and advantages of the saver's credit.

In sum, we can get more employers to offer IRA savings opportunities to workers with simple, low-cost, low-risk alternatives like those I have described. Enhanced retirement savings incentives like these are the most effective investments we can make, as a nation. Thank you.

[The prepared statement of Mr. Hardock follows:]

STATEMENT OF

RANDY HARDOCK

ON BEHALF OF

THE SAVINGS COALITION OF AMERICA

BEFORE THE

SUBCOMMITTEE ON SELECT REVENUE MEASURES
OF THE
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

AT THE HEARING ON

“THE ROLE OF INDIVIDUAL RETIREMENT ACCOUNTS
IN OUR RETIREMENT SYSTEM”

WASHINGTON, D.C.
JUNE 26, 2008

Statement of
The Savings Coalition of America
U.S. House Ways and Means Select Revenue Measures Subcommittee Hearing on the "Role of
Individual Retirement Accounts (IRAs) in Our Retirement System"
June 26, 2008

Good morning. My name is Randy Hardock. I am the managing partner of the Washington, D.C. law firm of Davis & Hamman LLP. I have been involved in retirement savings issues in Washington for over 25 years, including service as Tax Counsel with the Senate Committee on Finance from 1986-1993 and as Benefits Tax Counsel at the Department of the Treasury from 1993-1995.

I am here today on behalf of The Savings Coalition of America, a nonprofit organization that promotes public awareness of the importance of personal saving and supports incentives to increase personal saving by Americans. The members of the Savings Coalition represent a wide variety of private interests including engineering, consumer groups, home-building, realtors, tangible assets, trust companies, the health care industry, banking, financial services, education, insurance, securities and business groups. The Savings Coalition would like to thank the members of the Subcommittee for focusing on the role that the various types of individual retirement arrangements ("IRAs") play in our retirement system, and for giving us the opportunity to comment today. A list of the members of the Savings Coalition is attached.

IRAs are a uniquely successful retirement savings vehicle that have become an essential pillar in America's retirement savings strategy. IRAs ensure the portability of retirement savings when individuals change jobs, and they provide critical savings opportunities and incentives for individuals who do not have access to employment-based plans or who wish to supplement savings outside of the employment relationship. From the time when IRAs were first created in 1974, and at each step of their evolution since then, the House Committee on Ways and Means has led the way. We commend the members of this Subcommittee for continuing efforts to further improve the effectiveness of the IRAs in assisting even more Americans prepare for a financially secure retirement.

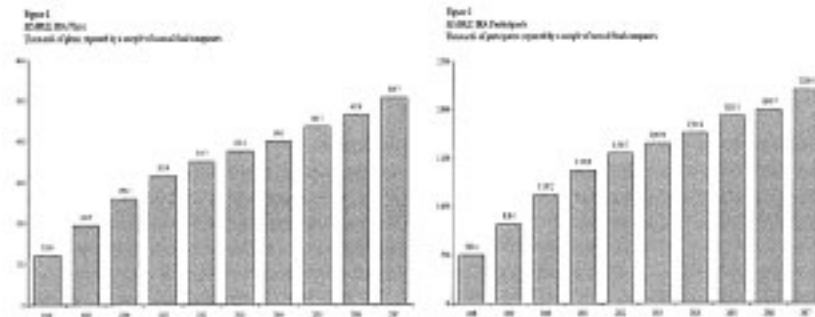
A report released earlier this month by the Government Accountability Office ("GAO") expressed concern that many employees of small employers who lack access to employer-sponsored retirement savings plans are not adequately saving for their retirement. We agree. GAO suggested certain actions to encourage more small employers to offer IRAs to their employees through the workplace. Our testimony touches primarily on policy changes related to the GAO report, with a focus on ideas to improve retirement savings through the use of SIMPLE IRAs, SEP IRAs, and other payroll-deduction IRAs offered by employers.

As a general matter, we would emphasize at the outset that policy changes will only be successful in encouraging more employers to provide retirement savings opportunities in the workplace if those employers are provided with simple, low-cost, low-risk alternatives. In addition, some type of incentive for small business owners and decision-makers to create an IRA option for their employees will also be important.

1. *IRAs are one of the most successful mechanisms for building retirement security.*

Congress created the traditional deductible IRA in 1974. Since then new types of IRAs have evolved and the eligibility and contribution rules have been altered several times. In 1978, Congress established the Simplified Employee Pension (SEP) IRA – an employer-based IRA. Between 1982 and 1986, Congress made the traditional IRA “universal” by allowing all workers under age 70½ to make tax-deductible IRA contributions. Beginning in 1987, Congress eliminated the universality of tax-deductible IRA contributions, but permitted workers meeting certain income limits to make such contributions even if they were covered by employer-sponsored retirement plans. In addition, after-tax, or nondeductible, contributions were permitted. In 1996, Congress added the Savings Incentive Match Plan for Employees (the SIMPLE IRA), an account targeted to small businesses and also increased the permitted contribution to spousal IRAs. Congress further expanded the menu of offerings again in 1997 with the Roth IRA and raised the income limits for IRA contribution deductibility. In 2001, Congress raised contribution limits for IRAs and those provisions permanent in the 2006 Pension Protection Act.

Today, the IRA successfully fulfills two primary functions. One is to give individuals not covered by retirement plans at work an opportunity to save for retirement on their own in tax-deferred accounts. The other is to provide portability for retirement assets by giving retiring workers or individuals changing jobs a means to preserve employment-based retirement plan savings by allowing them to transfer, or roll over, plan balances into IRAs. The IRA has been tremendously successful in serving both of these intended purposes. As noted by the GAO report, the estimated \$3.5 trillion held in IRAs in 2004 exceeded the estimated assets held in employer-sponsored defined contribution plans (\$2.6 trillion) and in defined benefit plans (\$1.9 trillion).



Efforts continue to further expand the utilization of the IRA by merging access to IRA accounts with the advantages of savings in an employment-based setting, including especially greater utilization of payroll-deduction mechanisms that have proven effective. SIMPLE IRA utilization, in particular, has grown steadily over the years. As reflected in Figures 1 and 2, below, a sample survey by the Investment Company Institute that was released earlier this week

indicates that at year-end 2007, at least 2,204,900 individuals participated in over 505,700 SIMPLE IRA plans, and that the number of such plans and the number of participants has increased each year since 1998.¹

Data on payroll-deduction IRAs is not readily available, as indicated by the GAO. Still, financial institutions that are members of the Savings Coalition report anecdotally that relatively few small employers have adopted payroll-deduction IRAs for the reasons outlined below.

II. *Barriers still exist that discourage small employers from offering employer-sponsored IRAs and payroll-deduction IRAs to employees.*

IRAs already offer one of the easiest options for small employers to provide savings vehicles to their employees. SIMPLE IRAs and SEPs offer somewhat streamlined rules which make it easier for employers to offer those plans relative to the costs and burdens associated with 401(k) and similar employer-sponsored plans. Offering payroll-deduction IRAs can be an even lower-cost option for small employers, because they do not involve employer contributions, they impose only minor financial reporting requirements on employers, and they allow employers to select a single IRA provider (or let employees select their own provider). Currently, payroll-deduction IRAs also have fewer requirements for employee communications than SEP or SIMPLE IRAs, and they do not subject employers to certain fiduciary responsibilities and requirements that apply to employer-sponsored pensions under Title I of the Employee Retirement Income Security Act of 1974 ("ERISA").

Although the growth of SIMPLE IRAs has been impressive, there remains a huge gap in employers providing any type of employment-based retirement savings option. The reasons are many, but based on the experience of our members most small employers will offer IRAs to employees only if they understand that they can do so simply, at a low cost, and at low risk. These employers are likely to proceed only if they are comfortable that they are not at risk of engendering lawsuits, having to deal with onerous government reporting or regulation, or exposing themselves to the potential for generating a new source of employee complaints.

There are a number of barriers that currently discourage small employers from offering employer-sponsored IRAs or payroll-deduction IRAs. The most important include:

- Administrative cost to small businesses;
- Concerns over potential liability;
- Inadequate incentives for decision-makers; and
- Limited employer and employee understanding of employer-sponsored IRAs and payroll-deduction IRAs.

The combination of these barriers discourage many employers from providing access to IRAs for their employees, thus limiting the effectiveness of IRAs in further facilitating retirement savings.

¹ See Investment Company Institute, *Survey of a Segment of Member Mutual Fund Companies* (based on a survey of firms representing 75 percent of all SIMPLE mutual fund assets at year-end 2007).

Cost Barriers – The administrative cost associated with setting up and managing payroll-deduction IRAs may be a particularly high hurdle for many small employers without electronic payroll systems or who do not outsource payroll functions. Without electronic payroll systems or a reliable outside provider, small employers are subjected to higher management costs if they offer payroll-deduction IRAs. Costs are also influenced by the number of employees participating and the number of IRA providers to which an employer must remit contributions on behalf of employees.

Liability Concerns – Another barrier to widespread establishment of payroll-deduction IRAs is the concern of employers otherwise not subject to ERISA that they will become subject to ERISA fiduciary requirements by virtue of offering payroll-deduction IRAs. The Department of Labor (“DOL”) has already issued helpful guidance on this issue in the form of Interpretive Bulletin 99-1 (29 C.F.R. § 2509.99-1). DOL clarifies that employers can select a single IRA provider for employees and provides their interpretation on when employers are not subject to ERISA fiduciary responsibility. Still, many small employers do not understand the scope or meaning of DOL’s Interpretive Bulletin. Some believe that codification and clarification of the DOL’s existing guidance could reassure more employers that they may offer payroll-deduction IRAs without becoming subject to ERISA.

Absence of Incentives – Another roadblock to the adoption of payroll-deduction IRAs by small employers is that there are no added tax incentives for the employer that provides the option. This absence is particularly important in the case of small business decision-makers. In practice, a small business owner (or a senior manager of a small business) has no personal incentive to establish payroll-deduction IRAs for employees, since that decision-maker can obtain the identical IRA independently on an individual basis. Moreover, for many small business decision-makers, the IRA may offer little tax advantage in any event, since complex eligibility requirements make planning difficult.

Similarly, there are no employer tax advantages for offering a payroll-deduction IRA. With the limits on contributions to payroll-deduction IRAs much lower than those applicable to SEP and SIMPLE IRAs, some small employers likely conclude that payroll-deduction IRAs are not worth the effort and resources required to establish them. This is particularly true for employers with a workforce that is not requesting retirement savings options, especially employers with relatively low-wage workforces.

Lack of Employer Education – Finally, many small employers do not know about the advantages of payroll-deduction IRAs or even that they exist. DOL has issued educational materials regarding payroll-deduction IRAs, but in spite of DOL’s efforts, many employers are still unaware that payroll-deduction IRAs are available or that employer contributions are not required. More needs to be done to make offering IRAs an attractive, low-cost option for employers and to educate employers about how payroll-deduction and other IRAs work.

III. *Adding new burdens or concerns could be counterproductive, discouraging small employers from offering IRA savings options for their employees.*

The GAO report recommends that Congress consider requiring certain actions by DOL to increase the direct oversight of payroll-deduction IRAs. While we feel that additional data on payroll-deduction IRAs would be helpful in analyzing the role of these IRAs in our retirement system, we strongly discourage any increased oversight or regulation that would impose new burdens on small employers or otherwise discourage them from making IRAs available to their employees.

For example, imposing reporting requirements on employers maintaining payroll-deduction IRAs would increase costs for all the employers offering those arrangements when the same data could be obtained through sampling methods that are less intrusive. Similarly, extending DOL's jurisdictional reach to payroll-deduction IRAs could subject those plans to ERISA regulation and would drive employers away from offering those types of arrangements. We note that Congress has long recognized that small employers historically have failed to provide retirement arrangements for their employees because of the administrative costs and burdens associated with establishing and maintaining such arrangements.²

We do believe that the Internal Revenue Service should be encouraged to share available information on these and other IRAs with DOL without requiring any additional information from employers, as GAO recommended. The Internal Revenue Service already collects considerable data on IRAs and that should be made available to DOL.

IV. *Policy changes that would remove barriers and increase incentives for small employers to offer IRA savings access to their employees.*

There are several legislative changes that would make it easier and more attractive for employees without access to employer-sponsored retirement plans to contribute to IRAs offered by small employers. As noted above, it is important that legislation lessen the existing barriers that discourage small employers from offering employer-sponsored IRAs and payroll-deduction IRAs to employees. This can be accomplished by simplifying these arrangements and helping small employers make them available at a lower cost and with less risk of employee complaints, lawsuits and additional government regulation.

Codification of DOL Interpretive Bulletin 99-1 – Incorporating DOL's Interpretive Bulletin 99-1 into statute or by some type of legislative reference could cause more employers to consider offering IRA savings access to their employees. That Interpretive Bulletin provides small employers with important safe harbor relief from ERISA Title I for payroll-deduction IRA programs that satisfy certain conditions. However, many small employers do not have an understanding of what an Interpretive Bulletin is and how much reliance can be placed on DOL's interpretation.

² See, e.g., STAFF OF JT. COMM. ON TAXATION, 100TH CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1986 464 (Comm. Print 1987).

At the same time, this safe harbor relief should be further clarified to give small employers (and financial institutions) greater comfort and flexibility to promote such programs without fear of being subject to the requirements of ERISA Title I that apply to employer-sponsored pensions. Similarly, employers should be given comfort that implementing a payroll-deduction mechanism that automatically defaults workers into contributing to an IRA will not subject the employer and the arrangement to ERISA Title I requirements. Our experience with 401(k) and similar retirement plans confirms that default enrollment can increase retirement plan participation significantly. We commend you, Chairman Neal and Mr. English for your efforts to promote default enrollment through IRAs and we look forward to working with you on those proposals.

Making SIMPLE IRAs Simpler – One recent improvement with respect to IRAs that was originated in part by this Committee was the creation in 1996 of the Savings Incentive Match Plan for Employees, or SIMPLE IRA. SIMPLE IRAs are arrangements that merge the flexibility and attractiveness of the IRA with a more limited employer role that has proven attractive to small businesses. Finding ways to further streamline and improve employee access and participation in retirement plans through the workplace, including SIMPLE IRAs and other payroll-deduction arrangements, should be one of the next areas that Congress considers as we continue to better assist Americans in preparing for a more secure retirement.

Still, SIMPLE IRA rules should be made simpler. Changes that would make SIMPLE IRAs less complicated and more attractive include eliminating the current law rule prohibiting a small employer from making a mid-year move from a SIMPLE IRA plan to another retirement plan, eliminating the current law restrictions on rollovers from SIMPLE IRAs to traditional IRAs and qualified plans, and lowering the penalty tax on premature distributions from a SIMPLE IRA to that which applies under all other qualified retirement savings vehicles. These changes are included in H.R. 5160, The Small Businesses Add Value for Employees Act of 2008, which was introduced by Representative Kind, along with Representatives Hulshof and English, on January 29, 2008.

Creating Incentives for Decision-Makers – Small employers need more incentive to make IRAs available to their employees. They need incentives to educate their employees on the benefits of using IRAs to save for retirement and encourage employees to contribute to IRAs.

A reasonable start-up tax credit for small employers, like that which is available on a larger scale for other employers, would help encourage small employers to establish and offer IRAs to employees. In this regard, H.R. 5160 would provide a start-up credit equal to 50 percent of the start-up costs for new plans and would allow for a one-time \$25 tax credit for each employee who enrolls in the savings program.

In addition, H.R. 5160 proposes two new features that are designed to encourage more small employers to sponsor a SIMPLE. One feature is an increase in the SIMPLE IRA contribution limit to be on par with the limit for other defined contribution plans such as the 401(k). In addition, employers who sponsor a SIMPLE would also be able to make additional contributions to their employees “across the board.” Currently, employers are limited to either a

2 percent non-elective contribution or a 3 percent matching contribution. This added feature would provide more flexibility without increasing complexity.

Still, many small employers will remain unwilling to adopt payroll-deduction IRAs because the current income eligibility limits and phase outs often make the IRA an uncertain option for small business decision-makers. Today, eligibility for traditional deductible IRAs, Roth IRAs and spousal IRAs can be determined only after the taxpayer works through a complex maze of eligibility requirements that include a variety of income limitations and phase-outs. Which of the various eligibility limits applies depends, in part, on the type of IRA the individual wishes to establish and whether the individual (or the individual's spouse) actively participates in certain types of employment-based retirement plans.

Even with recent improvements, the fact remains that many middle-income Americans are still not eligible for a fully deductible IRA. Although the Roth IRA was wisely made available to a broader segment of the population, the application of income limits on Roth IRAs remains detrimental. The current income limits also impose a severe marriage penalty on certain couples. To make matters worse, many small business owners do not know their income until the end of the year, making IRA eligibility uncertain in advance and from year to year.

In sum, the current IRA eligibility limitations (which were initially included in the Tax Reform Act of 1986) do far more harm than good. Those limitations substantially impair the potential effectiveness of IRAs as a savings promoter and should be repealed. They also act as a substantial deterrent to the establishment of payroll-deduction IRAs.

Our experience has shown that the people who are harmed most by the income limits are not the wealthy. To the truly wealthy, the relatively small IRA tax advantage does little to effect their overall tax burden. The people who are harmed by the income limits are those who are stuck in the middle. These are people who do not necessarily have sophisticated tax planners and accountants giving them advice. They will only proceed in committing their money into an IRA if they are confident that they will not get tripped up by the rules. Some of these people will delay contributions to make sure they will qualify, and then later forget to make the contribution or spend the money before they get around to making a contribution. Others may qualify for a full or partial IRA this year, but still will not contribute because the contribution permitted this year is too small, or because they assume they won't qualify in the future and they don't want to start contributing if they are not sure they will be able to continue the process in future years. Still others are confused and believe they may have to withdraw the funds if their income goes up in the future.

The end result of today's complicated limits on IRA eligibility is that contributions are not made by many of those who are technically eligible (or partially eligible) under the rules in a given year. This same chilling effect has been in effect since Congress originally imposed income limits on deductible IRA eligibility in the 1986 Tax Reform Act. Before that the IRA was available to all Americans with earned income. The year after the income limits on IRAs went into effect, contributions by those who remained eligible dropped by 40%.

Restoring universal IRA eligibility -- the rule that was in effect before 1986 -- would help all Americans to save more. By eliminating the complexity in the current rules, Americans will be presented with a consistent and understandable pro-savings message -- a clear consensus path to follow toward retirement security. That message will be reinforced by the general media, financial press, financial planners, and word-of-mouth. As families gain confidence in the retirement savings vehicles available to them, more and more will commit to the consensus path. Without the complex income limits, we would see increased savings among all income classes. We would also see more small business decision-makers who would be willing to offer IRAs through the workplace.

Educating Small Employers -- It is not enough to remove the barriers that small employers face to offering IRAs to their employees. It is crucial that awareness by small employers and their employees of the availability and benefits of SIMPLE IRAs, SEP IRAs, and payroll-deduction IRAs be increased. In this regard, the Internal Revenue Service and the Small Business Administration can provide invaluable information and education to small employers and employees on these retirement savings options. At the same time, they should be providing additional information on the availability and advantages of the savers credit for their workers. We urge that they be directed to do so as part of their normal small business compliance outreach efforts.

* * * * *

In conclusion, IRAs are uniquely positioned to address the concerns raised in the GAO report that many employees of small employers who lack access to employer-sponsored retirement savings plans are not adequately saving for their retirement. We believe that these employees can improve their retirement savings in employer-provided IRAs and payroll-deduction IRAs through policy changes like those discussed above that provide a simple, low-cost, low-risk option for employers.

Enhanced retirement savings incentives are the most effective investments we can make as a nation. Those investments will pay back many times over in increased retirement security for Americans, a stronger economy, and a reduced dependence on government resources by Americans during their retirement. For these reasons we urge the members of this Committee to continue your efforts to expand access to IRAs through the workplace and to strengthen IRAs overall.

Once again, the Savings Coalition commends this Subcommittee on the leadership it historically has shown on retirement issues. On behalf of the Coalition, I would like to thank the members of this Subcommittee for your time and consideration of this important issue.

**SAVINGS COALITION OF AMERICA
MEMBER ORGANIZATIONS**

America's Community Bankers
 American Bankers Association
 American Century Investments
 American Council for Capital Formation
 American Council on Education
 American Homeowners Grassroots Alliance
 American League of Financial Institutions
 American Nurses Association
 American Shareholders Association
 Americans for Tax Reform
 Ameriprise
 Charles Schwab & Co., Inc.
 Consumer Bankers Association
 Credit Union National Association
 Fidelity Investments
 Financial Planning Association
 First Trust Corporation
 Independent Community Bankers of America
 Independent Insurance Agents of America
 Industry Council for Tangible Assets
 Institute for Research on the Economics of Taxation
 Institute of Electrical & Electronics Engineers - United States of America
 Investment Company Institute
 Lincoln Trust Company
 Merrill Lynch & Company, Inc.
 Morgan Stanley
 Mortgage Bankers Association of America
 National Association for the Self-Employed
 National Association of Enrolled Agents
 National Association of Federal Credit Unions
 National Association of Home Builders
 National Association of Independent Colleges and Universities
 National Association of Realtors
 National Association of Real Estate Investment Trusts
 National Association of Uniformed Services
 National Rural Electric Cooperative Association
 National Taxpayers Union
 PENSCO Trust Company
 Platinum Guild International (USA) Inc.
 Real Estate Roundtable
 Resources Trust Company
 Retirement Industry Trust Association
 Retirement Accounts, Inc.
 Savers & Investors League
 Securities Industry Financial Market Association
 Silver Institute
 60 Plus Association
 Sterling Trust Company
 USAA
 United States Chamber of Commerce

Chairman NEAL. Thank you. I thank all of the panelists.

Mr. Estrada, you testified about the interactive effect of auto-IRAs and the saver's credit. It's come up a number of times in this panel's presentation. Can you explain how this would work?

Are there suggestions that you might have for improvement?

Mr. ESTRADA. Yes, Mr. Chairman. I'm sure Mr. Iwry would have something to say, as well.

I think the first thing is we all understand the under-utilization of the saver's credit. In fact, it occurs because it's most appropriate for people of lower income, of lower earnings. Therefore, what happens is that we don't—those are the very individuals who are not saving.

So, the interaction between these two is that the automatic IRA would provide a savings that would take place, and then that savings would now become part of the abilities to take advantage of the saver's credit. So, these two would then increase the number of people using the saver's credit, and I think, most importantly, give us a whole new group of savers that need to be those that can take advantage of this program.

Chairman NEAL. Any other panelists? Mr. Iwry?

Mr. IWRY. Mr. Chairman, I would entirely agree, and add that the Emanuel Ramstad bill to expand the saver's credit would do even more to provide incentives to save for the people who really need those incentives the most, essentially beefing up the saver's credit by making it refundable, by making it depositable to the account in which the person saves, such as the automatic IRA, so that the credit is actually saved, automatically, and by simplifying it and extending it to more of the middle class.

Those are attributes that the proposed saver's credit had when it was first proposed by the Treasury Department, but were cut down in the legislative process. So, that would further enhance both savings and 401(k)'s to which it would apply, and the appeal of the automatic IRA.

Chairman NEAL. Let me follow up with you, Mr. Iwry. We have heard some concern that IRAs should not displace 401(k) plans, which are more effective retirement vehicles. But you also argue that auto-IRA programs might actually spur growth in these other employer-provided plans. Can you explain your graduation theory?

Mr. IWRY. Absolutely, Mr. Chairman. Your bill really has, in a sense, two goals: one direct, and one indirect. The direct goal is to use automatic payroll deposit to IRAs to extend retirement savings to tens of millions of people who don't have it now.

But the indirect goal is to actually encourage employers to adopt 401(k)'s, SIMPLEs, other plans that involve employer contributions. It is designed to bring employers into the system who are currently not willing to adopt any of those plans, either at the beginning, when an employer realizes that it would be offering payroll deposit to its employees for the first time, to give them the opportunity to save on a tax-favored basis, or after a year or two of experience with that.

There is every reason to expect that a significant number of employers would realize that jumping up, stepping up to a 401(k) or stepping up to a SIMPLE IRA would be easy and to their advantage, that their employees like tax-favored saving, that the employ-

ees value the employer's role in making that available, and that recruitment and retention of valuable employees is enhanced by the sponsorship of a plan.

That is why a number of the entities, people who market plans to small employers, have found the automatic IRA to be a very promising way to actually expand 401(k) formation.

Chairman NEAL. Mr. English?

Mr. ENGLISH. Thank you, Mr. Chairman. Mr. Iwry, I wonder if you could respond to the point raised by Assistant Secretary Campbell in his testimony, which I believe you may have been here to overhear, making the—raising the concern that under an auto-IRA model, it isn't necessarily clear who would protect employees from excessive fees, potentially dangerous investment decisions, or other challenges.

How would this concern be best addressed, and how can we work, legislatively, to ensure that workers are protected in these types of plans?

Mr. IWRY. That is a very appropriate and important issue, of course. There are a number of ways in which the bill already takes steps toward that.

Number one, an employer is required to remit employee contributions to the IRAs, just as an employer is required to remit income tax withholding, or other payroll taxes to the appropriate Federal tax deposit institution. The IRS would have authority to impose penalties, under the tax system, if employers did not remit employees' withholdings.

So, there is a mechanism there. Of course, one would expect that employers would comply, and that these penalties are not intended to be imposed, but just as a deterrent, and as something to give employees the comfort that I think you're alluding to, that there is an enforcement compliance mechanism.

With respect to the investment, there would be a default investment similar to the QDIAs, the qualified default investment alternatives, that Brad Campbell and his predecessor, Ann Combs, oversaw in the Department of Labor regulations. They have had a huge impact on the market in the 401(k) world.

Those kinds of default investments that are essentially standardized, asset allocated, have proven to be very popular, both with employers and employees. The bill contemplates that a similar approach would be taken, that there would be a prescribed kind of default investment, flexible enough so different financial institutions could provide them, but sufficiently uniform that we would have the comfort that they are reflective of good policy.

Mr. ENGLISH. Thank you. Mr. Hardock, you mentioned that one barrier preventing more employers from offering IRAs is that many Americans are not eligible to contribute to IRAs under current law, and that eligibility rules sometimes can be complicated.

Could you provide us with more details as to how eligibility, in your view, should be expanded, or made simpler?

Mr. HARDOCK. I think it's very important, and the Savings Coalition has long supported universal IRA availability, that every American should have the same access to the IRA and the tax advantages of the IRA.

If you look at the current contribution limits on deductible IRAs, they phase out for single individuals between \$53,000 and \$63,000; for married couples, \$85,000 to \$105,000. But if you want a spousal IRA, the phase-out is—kicks in at \$159,000, and starts to phase out over a \$10,000 range.

The Roth IRA limits are different for single, for couple. There are marriage penalties in some of those limit phase-outs. There are not marriage penalties in others. The list goes on, on how complex it is for people to determine where they're going to be during a year when they may not even know what their income is, and it makes it very hard to make that IRA decision.

Mr. ENGLISH. That's an excellent point. Mr. Chairman, I think this is something that, over time, I think the Subcommittee could play a particularly useful role in focusing on.

Mr. HARDOCK, one of the barriers you're bringing up, and you have mentioned, is that the contribution limits to IRAs under current law are, I gather in your view, relatively low. The advantages of IRAs are sometimes outweighed by the hassle and cost.

You know, what else could be done to correct this situation?

Mr. HARDOCK. Well, I think the key ingredient, particularly in the employer setting, if we want employers to do it, is to find ways to keep the employer costs down to offer this alternative. Mr. Iwry just talked about the importance of keeping the costs down for the individuals also within the IRA context. That means the rules on IRAs could be simplified, so there is less paperwork, less—

Mr. ENGLISH. Sure.

Mr. HARDOCK [continuing]. That the financial institution might have to provide, so they could even provide those cheaper. Those are the kinds of cost issues, ultimately, that this comes down to for individuals and employers.

Mr. ENGLISH. Where do you view—I mean, at what level do you think the contribution limits to IRAs should be adjusted to?

Mr. HARDOCK. Now, those are difficult revenue decisions. I think—

Mr. ENGLISH. Let's take it out of the revenue view. I am looking at it more—what would be the levels at which it would maximize the benefit, from a savings standpoint?

Mr. HARDOCK. Well, from a savings standpoint, I think unlimited IRA contributions—

Mr. ENGLISH. Okay.

Mr. HARDOCK [continuing]. Would maximize the savings. But many investments—

Mr. ENGLISH. But are there some other policy issues that, apart from just the question of revenue, that maybe could set—you know, give us guidance here?

Mr. HARDOCK. I think that many have argued that the IRA limits for people who don't have access to employer plans may not be adequate, and that those people maybe could use a little more annual savings, if somehow you don't have access to an employment-based plan. The IRA limits might not be enough. Those could be increased somewhat, I think, going forward.

But in the end, it really does come down to how much it's going to cost. You know, there is the tension there.

Mr. ENGLISH. Yes.

Mr. HARDOCK. That's why they are where they are now.

Mr. ENGLISH. Now, Mr. Eisenbrey, you have offered us what I think is the familiar critique from the left of IRAs. But would you not concede that IRAs have been an extremely successful savings vehicle for the middle class, and made a significant contribution to at least current pools of retirement savings?

Mr. EISENBREY. No, I guess I am sorry, I can't agree, Mr. English. The——

Mr. ENGLISH. So, you feel they primarily benefit more affluent people?

Mr. EISENBREY. They absolutely have. And——

Mr. ENGLISH. With the contribution levels?

Mr. EISENBREY. You know, when you look at—you just have to look at this in terms of, you know, return on investment. Back when, you know, we passed ERISA, and when you created the IRA, the amount of savings by the average American, you know, was—the savings rate for all Americans was about nine percent.

Mr. ENGLISH. Mr. Eisenbrey, that was——

Mr. EISENBREY. It's now zero.

Mr. ENGLISH. There are a whole variety of factors that have kicked in to the decline of savings rates.

Mr. EISENBREY. Absolutely.

Mr. ENGLISH. I think it's really very hard to focus on IRA tax policy as having driven it. What—I guess what income range would you say defines the middle class?

Mr. EISENBREY. Well, you can define it—Members of Congress often define it up to, you know, people earning \$250,000 a year. But the median income in the United——

Mr. ENGLISH. Do you define it that way?

Mr. EISENBREY. No, the median income in the United States is less than \$40,000 a year.

Mr. ENGLISH. Yes.

Mr. EISENBREY. Half of all Americans in the work force are making less than \$40,000. So, when your policy concentrates on raising the limits for people who can put away \$20,000 a year or more into tax-favored accounts, you are——

Mr. ENGLISH. But what about those——

Mr. EISENBREY. You are leaving half of the work force completely behind.

Mr. ENGLISH. But what about those who have incomes that vary, and will be in situations in 1 year to kick in \$20,000, but not in year 2, 3, and 4. What about the——

Mr. EISENBREY. That's a minority, it's a very small minority of people who ever have the ability to put away \$20,000 a year into a retirement account. Half——

Mr. ENGLISH. That's true, except that there are some people who are—who have a large realization, or will, through sales, achieve a—you know, a bulge in their income. You don't think there should be a tax incentive for them to set aside money?

Mr. EISENBREY. I think that our policy has focused so much on people who are in the top 20 percent of income, that we have completely lost sight of the fact that, as other witnesses have said, half of the work force has no employer-provided pension at all. A third of people will retire——

Mr. ENGLISH. So, you still—

Mr. EISENBREY [continuing]. With only Social Security.

Mr. ENGLISH. You still haven't given me the income parameters for the middle class, in your view.

Mr. EISENBREY. Well, you—if you wanted to take the middle third of the income distribution, and say that was the middle, I—if you took the middle 80 percent of the income distribution, the middle class would end at about \$130,000 of income in a year.

Mr. ENGLISH. So, you would say—

Mr. EISENBREY. That's the middle 80 percent, just, you know, taking the top 10 and the bottom 10, saying they're not middle class, everyone else is. You know, you would not be focusing on people who could put \$20,000 or more away a year into their retirement account.

Mr. ENGLISH. Well, I have a feeling that probably ideology has crept in here, so I'm going to turn this back to you, Mr. Chairman.

Chairman NEAL. But I think that you did raise a good point, Mr. Hardock responded, Mr. Eisenbrey responded, and I think the other panelists might have some interest in responding to the suggestion that Mr. Hardock offered, and that was that we ought to just take off any income guideline on the ability to contribute to an IRA.

Mr. Salisbury, you seemed pretty anxious earlier to speak to that issue.

Mr. SALISBURY. Oh. The comment I was going to make is that the—Randy was mentioning the issue of universal. If you go back to the 1980s, when they were still universal, even though at lower contribution limits, is the complexity created within the system drove the percentage of individual taxpayers contributing to these programs from what was a high of 16.7 percent of taxpayers down to last year, the last year we have data, 3.8 percent of taxpayers, because of the absence of selling, the absence of clarity.

So, I mean, you get the irony. If the government wanted to have the revenue loss be the same, except that it would be the same, then you would get far more individuals contributing to IRAs, most particularly low-income individuals, if you lowered the limit of what could go in, but let anybody put it in, so that, in essence, there would be a far more aggressive approach.

So, I think it's really a matter of what the objective of the policy is, and who it wants to be targeted at. There are ways, clearly, to have more people create IRAs, more people put money into IRAs. But like all retirement plans, very few individuals decide to do this on their own. Few employers decide to do it on their own. It's a question of the level of sales effort made by the society, and by the institutions. We have the social experiment, so to speak, 1981 to 1986, and we know the power of universality, even at lower contribution rates, if one wants to balance the revenue loss.

Mr. HARDOCK. Mr. Neal, may I just add something?

Chairman NEAL. You sure can.

Mr. HARDOCK. As Mr. English said, we let politics creep into this. I think Mr. Hulshof said it earlier. These issues have historically been bipartisan.

Chairman NEAL. Yes.

Mr. HARDOCK. The issue of how progressive your Tax Code is can be dealt with in a lot of other contexts, and it's a difficult issue. If you can keep that out of the pension/retirement debate, and keep this on the lines of how do we get more people to save, then the data that Dallas just showed, the 40 percent decline in IRA contributions by those who continued to be eligible after the 1986 Act went after effect, we can get more savings and you can get your progressivity somewhere else, if that's what you want.

But if you do it through the system, you get a hugely complex maze of phase-outs and nobody knows where they are, and what you get is paralysis.

Mr. EISENBREY. I think Randy would agree with me, though, that the most important incentive is a financial incentive. If you give a much smaller financial incentive to a low-income person to save, that person is going to save less.

So, if you gave the same—and it has to be through a refundable credit, as Mark Iwry was saying. But if you don't give a low-income person the same incentive, and you know, financial incentive, they won't be able to save as much.

Mr. HARDOCK. The saver's credit was a huge step forward in that direction, and I think there is that incentive part of it. There is also the water cooler effect part of it, which I think gets lost when economists talk. There is a buzz that develops. That is what I think the auto-IRA is trying to do, and other things, also.

Chairman NEAL. Why don't we recognize Mr. Iwry?

Mr. IWRY. Mr. Chairman, the first rule here, of course, should be first do no harm. In thinking about the appropriate level of IRA contributions, the related rules relating to the ability to contribute to an IRA, the most important consideration I would suggest is that we do nothing to threaten the employer plan system, that we do everything we can to protect the 401(k)'s, the other retirement plans we've got, the incentive to adopt those, including the SIMPLE plan, which I might note Randy Hardock and I originated with our proposals when we were working together at Treasury and Congress then enacted.

The rules for IRAs, therefore, have to be part of the ecology, if you will, of the whole retirement system, set at a level that gets universal participation through your kind of proposal, the automatic IRA, but not at a level that would detract from the incentive to sponsor an actual employer plan. Your bill is attuned to that sensitivity, so that it would actually enhance that incentive, and make it more thinkable for employers to take that step up and adopt a SIMPLE or a 401(k), in addition to or after adopting an automatic IRA.

Chairman NEAL. Thank you. The gentleman from North Dakota, Mr. Pomeroy, is recognized to inquire.

Mr. POMEROY. I thank the chair. Again, just to echo comments I made earlier about how much I am enjoying this hearing, I commend each of you for your very thoughtful questions and leadership in the course of this morning.

Let's—I think that the data, just the data alone, is empirical. Regardless of which way your politics takes you in terms of its interpretation, conclusions you draw from it, it's important that we master the data here. Let's start by understanding what has been hap-

pening in the retirement savings world. So, let's start with both defined benefit pensions and defined contribution plans sponsored in the workplace, and let's look at this decade, what is happening.

My belief is that we have had some decline. Dallas, perhaps, as the keeper of the data, do you want to speak to that?

Mr. SALISBURY. Congressman, we have seen a substantial decline in proportion of individuals in defined benefit plans. That has gone from about 28 percent of—with active participation, about 17.2 percent.

We have seen very dramatic increases in defined contribution plans at the workplace, both in participation and assets, and we have seen a relatively flat process vis a vis Individual Retirement Accounts. The 3.7, 3.8 percent contributing to a deductible IRA has been relatively constant. We have seen a growth in the number of individuals contributing to Roth IRAs. That's now up to about 3 percent of taxpayers.

In relative terms, as I noted, the percentage of taxpayers in defined contribution plans on an annual basis contributing on a deductible and/or Roth basis is about six times the number that are contributing to Individual Retirement Accounts.

Mr. POMEROY. But is that defined contribution number holding steady? The way I was interpreting current population survey data was that there had been, actually, an increase—a decrease there, also.

Mr. SALISBURY. It has—it flattened in the last 3 years, and is slightly now declining, as it appears that the sales efforts have apparently reached a saturation point. Now that automatic enrollment is being put in place, we are likely to see, with data in the next two to 3 years, an increase in the number of active participants, as a result of the defaults that were contained in the Pension Protection Act. Number of plans has actually slightly declined.

Mr. POMEROY. Is there hope for saving the defined benefit portion of the marketplace?

Mr. SALISBURY. Very frankly, very little reason to think that that will occur. Most of the new plan formation of defined benefit plans has been so-called hybrid, or cash balance plans. They now represent in excess of 30 percent of plans.

We are seeing some creation of hybrids by relatively small businesses that are using them because of the more advantageous deductibility limits than they would have under a defined contribution plan.

We are seeing a rapid pace of even the nation's very largest private employers making announcements, including one that came out of Boeing Company yesterday, that they are moving—where they have the ability to move their workers from defined benefit to defined contribution, they are doing it. Boeing has just announced that earlier this year. Northrop Grumman announced that.

A small firm that's been in the news lately, Fannie Mae, announced that within the last month. They will—Fannie Mae will, interestingly, be retaining its unfunded defined benefit plan for its highest paid executives, even though it will be eliminating it for all other employees.

Mr. POMEROY. Very interesting. Very pathetic, I might say.

Mr. Eisenbrey, what do you think the—what is the circumstance for the worker, as they move from having a defined benefit plan to a defined contribution option, only?

Mr. EISENBREY. Well, they are clearly worse off. I mean, they end up with an employer making less of a contribution, by and large. They end up with more risk. They end up having to make decisions that they're not prepared to make about investments.

I am sure you read the story a few years ago by Peter Gosselin in the LA Times, talking to Nobel Prize winners in economics about their ability to make investment decisions, and many of them admitted that they, you know, weren't doing a very good job, and had trouble doing it. It's not something that the average person is prepared to do, to make, you know, wise investment decisions for the rest of his life.

Mr. POMEROY. Yes. I haven't seen the proposal that you advanced today. Do you—is this—do we just have to accept that, of the 20 million that still have defined benefit plans, that that is going to be a vanishing protection for them?

Mr. EISENBREY. Well, our proposal helps in the sense that by—it takes away the incentive for employers to provide a 401(k), which has led—it's the 401(k), the existence of it, that has moved, you know, so many employers out of the defined pension, defined benefit world. I mean—

Mr. POMEROY. Well, the broader—

Mr. EISENBREY. If we hadn't created the 401(k)—

Mr. POMEROY. We have had a decade of—

Mr. EISENBREY [continuing]. We would have way more traditional defined benefit pension plans.

Mr. POMEROY. But we have had a decade, though, of even looking at wages alone, where middle class earnings have stalled out. The productivity gains that our economy has made have been deposited disproportionately at the highest elevations of income, and we have greater income disparity than ever before.

Mr. EISENBREY. That's true.

Mr. POMEROY. So, I mean, I believe that—I don't blame 401(k)'s for the demise of defined benefit plans. I believe that we have got, basically, an economic trend that I believe has been facilitated by the policies of this Administration that has exasperated income disparity by promoting the interests of the—those at the top earning brackets, and doing very little for those medium and below.

Mr. EISENBREY. Well, I think that that's true, but it's a 30-year or a 35-year trend. It isn't just something that began with the Bush Administration. I have to say that this goes back as far back as the Carter Administration, that we started seeing that gap between productivity and wage—

Mr. POMEROY. I will accept that part. I want to get Mr. Iwry in here with his perspective, as a former Treasury official. What is your view of the marketplace, and what can be done?

Aside from your proposal to get the broader IRA opportunities out there, what can be—is there something we can do to shore up pensions and basically enhance retirement savings prospects?

Mr. IWRY. Yes, Mr. Pomeroy. There are a number of things, one of which is to build on the work that you have done in the past,

and that we have worked on together when I was at Treasury, to expand the saver's credit, to have a refundable credit that reaches more of the middle class, that even, ideally, might be deposited into the accounts in which people save, or at least they might have the option to do that.

I also salute your championing of defined benefit plans in an era where that's becoming an increasingly lonely exercise. One glimmer of hope I would offer there is that I think one of the cardinal virtues of the defined benefit plan that you're more sensitive to than virtually anyone in Congress, I think, is, of course, the lifetime guaranteed income, and the conversion to cash balance plans, which has its—which, once done in a way that protects older workers, so that it's not unfair to them, and not too harsh a change, is at least something that preserves the defined benefit plan in some form.

That conversion also has a downside, which as you know, is to take the traditional defined benefit annuity-oriented plan, and convert it to the lump sum plan. The cash balance plan is the lump sum plan.

But it does not have to be. The fact that the benefit is framed as an account balance, and is almost invariably paid out in the vast majority of cases as a lump sum, largely because of the framing and the encouragement to do that, is something that I believe we can work with. There are a few cash balance sponsors that don't pay lump sums. Very few. There are more who could, potentially, encourage annuitization, rather than encouraging lump sums across the board, the way they do now.

So, what I am suggesting is that, apart from trying to revive the dying patient, we can at least do an organ transplant from the traditional defined benefit into the hybrid and the 401(k) space.

Mr. POMEROY. Yes, on the 401(k) space—this will be my final question, Mr. Chairman, I appreciate your letting me go on here for a minute—the—is there something we can do to get the 401(k) nest egg annuitized, to provide—can we make defined contribution plans act like defined benefit plans?

Mr. IWRY. Absolutely, Mr. Pomeroy, and that's been the strategy that I think, really, Treasury started promoting 10 years ago, when automatic enrollment was first defined and approved and promoted, almost 10 years ago to this day, in Treasury rulings.

The strategy is now playing out in the market. As we see, there is a kind of a de-beatification of the 401(k), which has not, however, yet reached the pay-out phase. We have de-beatified enrollment through auto-enrollment, we have de-beatified investments through the QDIAs, default investments, and the market is now—the industry is now, I think, exhibiting an extraordinary degree of creativity and innovation in developing products designed to annuitize part of that account balance in the 401(k).

I would very much look forward to working with you and you, Mr. Chairman, and other Members of this Subcommittee and the Committee. I know there are others on this panel and in this room who would share that interest, to try to de-beatify that pay-out phase as well, and at least encourage lifetime guaranteed income.

Mr. POMEROY. We are on the same page on that one. Thank you very much. Thank you, Mr. Chairman.

Chairman NEAL. Thank you, Mr. Pomeroy. I want to thank the panelists. This was most helpful. As you know, there was a pretty good turnout here at one point, and a lot of Members of the Subcommittee were here. Most importantly, I think, to determine the level of interest, there were a lot of Members who are not on the Subcommittee who showed today. I would predict flatly that next year this is going to be one of the most important avenues of debate in the congress.

So, I thank you all for your participation. Without any additional comments, the hearing is adjourned.

[Whereupon, at 1:11 p.m., the hearing was adjourned.]

[Submissions for the Record follow:]

The American Council of Life Insurers (ACLI) appreciates the opportunity to provide our views to the Committee on Ways and Means, Select Revenue Measures Subcommittee, in connection with the Subcommittee's hearing on Individual Retirement Accounts (IRAs) and their role in our retirement system. We welcome the interest of Subcommittee Chairman Neal, Ranking Member English and other Members of the Committee on this important topic. In addition, we also want to thank Chairman Neal and Congressman Kind for their interest in this issue by introducing bills which address retirement plan coverage. ACLI supports efforts to increase retirement savings coverage.

During the past several decades, Congress has taken the laudable steps of increasing and improving incentives for employment-based retirement savings plans. 401(k) type plans provide a convenient and successful means by which workers can save. To date, over \$2 trillion has been set aside in these plans for retirement. However, more needs to be done.

It is estimated that approximately 75 million workers lack access to a workplace savings plan. We are appreciative of those members of Congress who have recently sought to focus the public's attention on this issue and, in particular, applaud the several Members of this Committee who have introduced legislation seeking to increase workplace savings opportunities. It is in this same spirit of increasing retirement savings coverage that the American Council of Life Insurers (ACLI) submits this statement with respect to proposals to increase workplace savings coverage and, thus, retirement security.

The ACLI represents 353 member companies accounting for 94 percent of the life insurance industry's total assets in the United States. Our member companies are among the country's leaders in providing retirement and financial security to American workers, providing a wide variety of products including annuities and pension products such as 401(k), 403(b), 457 plans, and Individual Retirement Accounts (IRAs).

In seeking a solution to the problem stated above, clear empirical evidence has shown that workers best save for their retirement in employer sponsored retirement plans. Also, new automatic enrollment features have shown remarkable success in getting workers to save. We believe retirement savings solutions should focus on workplace savings and leverage the success of automatic enrollment. As Congress moves forward in assessing proposals to expand workplace savings coverage, we would urge that the following principles be considered.

- *Solutions Should Leverage/Enhance Existing Retirement Plan Framework*—Efforts to enhance coverage should lead to more coverage without encouraging a reduction in benefits to existing workers, i.e., done in a way to ensure 401(k) plan sponsors keep their plans in place. Congress and the States role should be to ensure that the laws support and encourage additional coverage, not to compete in or replace the competitive market place of retirement plan products and services.
- *Expand Automatic Contributions Arrangements to Include IRAs*—Employers without a retirement savings plan should be permitted and encouraged to automatically enroll employees into an IRA. Automatically enrolling employees in a savings plan has been shown to dramatically increase participation rates. "Auto-IRA" sponsors should receive the same level of fiduciary protection and state wage law preemption offered to employers sponsoring eligible automatic contribution arrangements.

- *Private Market Place Positioned to Support Coverage Expansion*—The private sector is fully capable of providing a diverse mix of IRA and 401(k) investment products and services at market competitive prices. Employers will find a wide array of products to suit employee needs.
- *Incentives for Lifetime Income to Ensure a Secure Retirement*—We believe that auto-IRA, 401(k) and other employer-based savings arrangements should include incentives for plans to include and participants to elect guaranteed lifetime income payments.
- *Encourage Auto-IRA, Auto-401(k) with Small Employer Tax Credit for Plan Start-Up Cost*—Small employers that provide payroll deduction IRAs should be eligible for a start up cost credit to offset the employer's initial plan formation and Administration expenses.
- *Enhance Saver's Credit*—We support enhancements to the saver's credit that would lead to greater savings in IRAs, 401(k), 403(b) and 457(b) plans, e.g., permit the credit to be deposited directly as additional savings to an employee's retirement plan.
- *Auto-IRA Withdrawal Rules Should Align with 401(k) Rules*—To ensure employees have adequate savings at retirement, auto-IRA withdrawal rules should be at least as stringent as the 401(k) rules, i.e., severance from employment, death, disability, 59½, hardship.
- *Encourage Financial Education Opportunities*—Coverage solutions should encourage employer support of access to and the use of financial education and planning tools to assist workers in balancing the monetary demands of today with future retirement needs.

Again, we applaud members of Congress for raising the profile of this important issue and the leadership they have provided on the subject. The ACLI looks forward to working with policymakers to bring workplace savings to all Americans.

Dear Chairman Neal,

CFED writes to thank you for sponsoring the *Hearing on IRAs in the Retirement System* on Thursday, June 26th. CFED is a nonprofit organization that works to expand economic opportunity by helping Americans start and grow their own businesses, go to college, own a home and save for their futures. We greatly appreciate the discussion of automatic enrollment and other key legislative proposals that help individuals connect to the financial mainstream, save and invest toward asset-accumulation, and achieve financial self reliance.

This letter outlines Federal wealth building policies and their inequitable impact, demonstrates the successes of programs and policies that enable low income families to build wealth, and suggests legislative improvements.

Dating back at least as far as Lincoln's time, the United States has provided incentives to its citizens to accumulate savings and build financial assets. From the Homestead Act through modern retirement incentives, the Federal Government has crafted various types of policies to assist households in their goal to become more financially self-reliant. This is, generally speaking, a good thing. Financial assets provide stability for families, help them plan for the future, and enable them to weather tough times. Providing incentives for people to build nest eggs strengthens the economy and fortifies the fabric of society.

Given these societal benefits, one would assume the nation would be best served by spreading the benefits of such policies as broadly as possible. In fact, on the grounds of both equity and effectiveness, a strong case can be made that those with the fewest resources to begin with should be offered the greatest assistance and strongest incentives to save. Those with low wages and few intergenerational resources are those who struggle most, yet have the most to gain, by building a sound and secure nest egg. Public policy could ensure they are able to do this effectively.

One recent effective public policy victory has been the passage of the Pension Protection Act in 2006 [P.L. 109-280]. One of the Act's components clarified businesses' ability to automatically enroll their employees into retirement plans. According to the U.S. Department of Labor, the PPA "removed impediments to employers adopting automatic enrollment, including employer fears about legal liability for market fluctuations and the applicability of state wage withholding laws." Now, nearly half of large firms are implementing automatic enrollment. In fact, 40% of those firms implementing auto enrollment adopted the practice over the past two years.

We are supportive of the expansion of—and technical corrections to—employer-sponsored retirement savings plans. We have learned that effective strategies for improving savings make it easier to save. As opposed to traditional plans where em-

employees must actively opt-in to a system, employers who adopt Auto Enrollment mechanisms enroll all employees into a 401(k) at a set percentage of their income. Employees who do not wish to participate can either change the terms of the plan or opt-out entirely. Through Automatic Enrollment, the savings incentive comes not only from counteracting employee inertia, but also through the provision of employer-matching funds. Retirement adequacy is aided by savings incentives from the employer in matches, and the Federal Government through tax benefits.

Automatic Enrollment boosts savings participation and wealth building, especially among groups which have historically had low savings and participation rates. For example, Auto Enrollment helps low-income workers save for retirement. Employees earning less than \$30,000 and hired under automatic enrollment have a participation rate of 77% versus a participation rate of 25% for employees at the same income level hired under voluntary enrollment. Auto Enrollment also helps address the personal savings crisis by reducing the number of 'zero savers' and counters inertia among renters and young people. Auto Enrollment helps people start saving at a younger age: 81% of employees younger than 25 are plan participants under automatic enrollment, versus 30% under voluntary enrollment.

However, unlike Auto Enrollment which seeks to equitably target all workers covered by an employer based plan, many policy initiatives intended to build wealth and accumulate assets do not reach all individuals. In our paper, Return on Investment, CFED finds that the U.S. devotes an enormous level of resources to asset-building incentives. These policies cost at least \$367 billion at the Federal level in Fiscal Year 2005. Yet, the biggest beneficiaries of this largesse are those households who need the least help in saving and investing. A disproportionate share of these incentives goes to very high-income households, at double the rate of what they pay into the system.

Meanwhile, low-income families who could use the most help, and even solidly middle-income families, receive a very low level of benefits from these policies. Analyzing the largest of these policies, our study found that more than 45% of the benefits went to households with incomes over \$1 million. These households received an average benefit of \$169,150. By contrast, the bottom 60% of the population shared among them not quite 3% of the benefits of these policies, or about \$3 apiece. The disparity between asset building incentives provided through tax policy and discretionary policy is profound: for every \$1 provided in discretionary programs, \$582 is provided through revenue foregone in the Tax Code.

The goals of existing policies are good ones: to encourage the kind of individual behavior that helps households and supports society. But how can these goals best be implemented?

The goal of homeownership policy, for instance, is grounded in a widely shared belief that homeownership has positive personal and social benefits, and that it is worth a national investment (in the form of direct spending and tax breaks) to help more households own homes. Likewise, the goal of retirement policy is grounded in an understanding that families need to supplement income and Social Security with targeted savings, and that it is worth a national investment (in the form of tax breaks) to help more families do so.

One would consequently think, to maximize impact, these policies would be most targeted to those who do not already own homes, or are not already saving for retirement. Surprisingly, the reverse is true: the bulk of the benefits of policies encouraging homeownership go to those who already own homes. The lion's share of these benefits go to the top wage earners, but nearly all (94.7%) of the top 10 percent of taxpayers already own their homes. By contrast, only four in 10 earners in the bottom 20 percent own their homes. Yet they receive little benefit from Federal incentives. Wouldn't tools better aimed at lower- and middle-income earners be more *effective* in attaining the social goal of helping more families own homes?

Likewise, if society has a goal of encouraging families to open and add to retirement accounts, one would imagine that the primary target would be those with the lowest levels of account ownership, and the lowest levels of capitalization. Yet we know that the benefits of these policies go disproportionately to higher-wage households. Only 10 percent of the bottom fifth in income earnings has accounts, with a median retirement savings value of only \$5,000, compared with 88 percent and \$182,700 for the top 10 percent. Policies meant to encourage this kind of saving could be more effectively targeted to the segments of the population that have the most growth potential.

There are a number of ways wealth building approaches could be reframed: Lower income caps, for instance, could be implemented on some policies, or a limit could be placed on the maximum benefit that any household could enjoy. Savings could then be reallocated to policies explained later in our comment letter that more explicitly target those who currently receive little benefit.

One particular area that deserves analysis is the role of tax expenditures. While direct outlays are subject to annual review through the appropriations process, tax expenditures often escape scrutiny and endure with little debate. Some experts, including a former IRS Commissioner and a Director of the Congressional Budget Office, have assailed the form of most of these tax expenditures—as deductions rather than refundable tax credits—as inherently inefficient. Because of the structure of many of these tax breaks, many families receive no benefit whatsoever, a fact that would be largely addressed by caps and conversions to refundable credits. Technically simple and budget-neutral fixes such as these could go far toward improving the effectiveness—and equity—of these policies.

Asset building policies, generally, promote good goals that help families and society. The price tag, however, is high enough that attention needs to be paid to what we are getting for our money. We believe that good policies can be improved to help more and more American families become financially secure.

As you noted, Chairman Neal, families in the greatest need of asset-building incentives benefit the least from policies such as Tax Code provisions intended to help generate wealth and promote savings. The good news is that we know that policies that directly target low-income families' opportunities for wealth building are effective. While these programs aim to help families build intermediate wealth (home, education, business), the lessons are also appropriate for retirement accounts; especially as IRAs are able to be used for homeownership and education without requiring payback or penalty.

The U.S. Department of Health and Human Services Office of Community Services recently released two major studies on the ability of matched savings accounts to help low-income working families save, buy homes, pursue post-secondary education and start businesses. The Assets for Independence (AFI) program's Seventh Annual Report to Congress finds that Individual Development Accounts (IDAs) are successful at encouraging savings, building assets and moving low-income families into the financial mainstream. IDAs are matched savings accounts that help low income families save for an asset which could be a home, a small business, or post-secondary education and training.

In addition, a five-year program Evaluation found significant differences between AFI participants in comparison to similar non-AFI participants. Individuals and families who participated in an AFI project were 35 percent more likely to become homeowners, 84 percent more likely to become business owners and nearly twice as likely to pursue post-secondary education or training.

Since 1999, AFI has provided funds to more than 390 IDA programs. The key findings from the Report to Congress find:

- More than 53,000 families have used IDAs and received money management training;
- Participants have saved more than \$38 million in their IDAs;
- More than 14,500 have used their savings to purchase any of the three allowed long-term economic assets;
- AFI participants saved an average of \$873, which represents a 15% increase since 2005 (\$756) and a 47% increase since 2003 (\$592);
- IDA participants deposited \$36.8 million in earned income into IDAs;
- Including match funds, AFI participants used \$49.2 million to purchase economic assets;
- 76% of IDA participants are female, 44% are African-American, 27% are Caucasian. Since 2002, Hispanic participation increased from 12% to 18%;
- Prior to enrolling in AFI, 52% of participants did not have a savings account and 91% had never used direct deposit; and
- The savings rate for AFI participants is 1.6% of annual income—compared with .5% for the national personal savings rate.

In addition to the AFI Report, the most recent IDA statistics from the Office of Refugee Resettlement (ORR) find:

- 19,065 IDA accounts opened with ORR funds;
- Nearly 16,000 assets were purchased, resulting in more than 2,700 new homeowners, more than 1,400 educational purchases and more than 1,100 small business start-ups; and
- Including match funds, ORR participants used \$68 million to purchase assets.

Based on the data from AFI, ORR and CFED's 2007 IDA Program Survey:

- There are now 73,000 IDA participants;
- 43% (31,500) of account holders have made an asset purchase;
- 27% (8,400) of asset purchases were for homes;

- 19% (6,000) of asset purchases were for education; and
- 17% (5,200) of asset purchases were for small business capitalization.
- There were also 11,700 purchases (37%) that were made by accountholders who participate in programs that allow IDA savings for other purchases, including cars, home repair, and computers or transferring an IDA to a spouse or dependent. These programs are useful for refugees, foster care youth, and others seeking to integrate into America's financial system for the first time.

Relatively simple shifts in public policy could make the proven benefits of incentives such as Individual Development Accounts available to a greater percentage of households. This in turn could make savings more effective and feasible for those who are living paycheck-to-paycheck.

We recommend that the Subcommittee on Select Revenue Matters take action soon to expand savings and wealth building opportunities for American families. We recommend the following legislative actions to ensure that the *infrastructure* for wealth building exists and that the *incentives* reach those families who currently do not save or whom hold insufficient savings:

Infrastructure: Policies should take advantage of opportunities to save and build wealth by using payroll deductions provided by employers, adding asset-building programs to services provided by nonprofits, and taking advantage of tax time when people are focused on their finances.

1. Support Automatic Enrollment in Individual Retirement Accounts:

IRAs can be utilized as a tool for helping low income people advance assets. Yet, these savings mechanisms could be more effective through the implementation of the bipartisan *Automatic IRA Act of 2007* (S. 1141/H.R. 2167). This act would extend payroll-based retirement savings opportunities to the vast majority of the 75 million employees currently without access to a retirement plan. Employers who do not sponsor a retirement plan would enable direct-deposit payroll deductions to an IRA and receive temporary tax credits to offset administrative costs. The law affects all employers in business for more than two years and with more than ten employees. In addition to retirement, IRAs, which can benefit from the Saver's Credit, can be accessed without penalty or payback for higher education and homeownership expenses.

2. Align intermediate uses within 401(k) and IRAs: We would like to see the Committee align rules for withdrawals from retirement accounts for education and homeownership, thus increasing 401(k) flexibility for intermediate savings goals. Currently, IRA funds can be utilized for educational attainment in the year that classes are taken. Also, up to \$10,000 in an IRA account can be used for first-time home ownership. These intermediate uses are only available as loans from 401(k)s. The law should align homeownership and education uses with retirement regulations so that the IRA rules apply to 401(k), 403(b) and other employer provided accounts. The \$10,000 lifetime limit for IRA homeownership withdrawals should be doubled due to the higher price of homeownership. This simple change would encourage more aggressive participant savings as employees would be able to save for an intermediate and a long term goal at the same time in a proven accessible mechanism.

3. Expand Roth IRAs for Youth. The law should permit adults to use a portion of their Roth IRA allocation to open accounts for minor children. Current law requires a child have earned income at least equal to the amount of the deposit to an IRA. Permitting flexibility would enable to adults to start and fund accounts for children in their lives (nieces, nephews, cousins, grandchildren, godchildren, etc.)

Incentives: The mortgage interest and property tax deduction and 401(k) and IRA tax benefits are some of the Federal incentives that explicitly reward asset-building behavior. Federal policies provide subsidies to encourage certain kinds of savings and investment and these should be expanded to reach low-income and moderate-income families. In addition, incentives can help ensure that the modest savings achieved by low-income and moderate-income families are adequate for downpayment and retirement security.

4. Expand the impact of the Saver's Credit: The bipartisan *Retirement Savings for Working Americans Act* (H.R. 2724) would provide a 50% match to households earning less than \$30,000 for an individual or \$60,000 for joint filers who save up to \$2,000 in a retirement or 529 college savings account or Coverdell. The match would be provided through the IRS Form 8888 directly to the retirement account instead of through a tax deduction.

5. Enact the Savings for Working Families Act: The bipartisan and bicameral *Savings for Working Families Act* (S. 871/ H.R.1514) ensures that our nation's savings and ownership policies assist working-poor families by enabling them to save, build wealth, and enter the financial mainstream through the use of a financial product tailored to their needs: Individual Development Accounts. IDAs add an asset component to income assistance and enable families to purchase an intermediate asset (home, college, or business) to help them become financially self-reliant. SWFA would provide a tax credit to financial institutions that match the savings of 900,000 low-income savers.

6. Reauthorize and Improve the Assets for Independence (AFI) program. AFI is a \$25 million IDA program that has been nearly fully funded every year by Congress and has also been recommended for near full funding by President Bush in his annual budgets. However, its reauthorization has expired. The program needs to be reauthorized and improved with technical changes to ensure that the program works better for IDA programs and their clients. Recommended changes include simplifying interest calculations and asset purchase processes, expanding resources for financial education, ensuring broader participation in rural areas, permitting people with disabilities to participate with SSI, and permitting greater flexibility on eligibility criteria.

7. Enact Children's Savings Accounts. More than a third of the 4 million American children born each year—and more than half of minority children—are born into families that lack enough savings to weather emergencies or to effectively invest in their children's futures. To ensure that all children are encouraged to increase and retain assets, *The America Saving for Personal Investment, Retirement and Education (ASPIRE) Act of 2007* (H.R. 3740) endows an account with a one-time, \$500 government contribution. Households whose income is at or below 50% of the national median income would be eligible for a supplemental initial contribution of \$500. As household income approaches 100% of the national median income, the KIDS Account would receive a lesser, evenly pro-rated contribution. Investments of up to \$2,000 per year can be added to the account. The income earned on the account is tax free. Children living in families whose household income is at or below 100% of the national median income will receive a dollar-for-dollar match on private contributions up to \$500 until the child reaches age 18. The match for private contributions will begin to phase out for households whose income is between 100% and 120% of national median income. Once the child reaches age 18, withdrawals can be made for post-secondary education. After the child reaches age 25, withdrawals can be made for homeownership and retirement. The bill also calls for financial education programs for families. ASPIRE encourages savings, promotes financial literacy, and expands opportunities by establishing a KIDS Account for every child born in the United States.

CFED encourages the Committee to analyze asset-building policies and promote those that have positive *impact* and proven *effectiveness*. CFED applauds your leadership to focus attention on Federal policies and corporate and individual action to promote asset building and retirement security.

Sincerely,

Andrea Levere

President

Massachusetts Mutual Life Insurance Company ("MassMutual") is a mutual life insurance company that was organized in 1851 in Springfield, Massachusetts. MassMutual is a member of the MassMutual Financial Group, which is a global, growth-oriented, diversified financial services organization with total assets under management in excess of \$500 billion as of end year 2007. Our family of companies serves the needs of over eight million clients by providing a broad-based portfolio of financial products and services, including: life insurance, annuities, disability income insurance, long-term care, retirement planning products, mutual funds, money management, and other financial products and services.

MassMutual, through its Retirement Services division, has provided retirement plan services for over half a century. Retirement Services provides a wide range of services to all segments of the retirement plan universe, including more than 4,800 defined benefit and defined contribution plans with more than one million partici-

pants. MassMutual, through its OppenheimerFunds subsidiary, has been satisfying the investment and retirement needs of investors for nearly 50 years and remains one of the largest and most respected names in the mutual fund industry. OppenheimerFunds 401(k)s and IRAs have access to more than 60 Oppenheimer mutual funds that represent a broad spectrum of investment styles and asset classes. According to *Pension & Investments* (May 26, 2008), MassMutual Financial Group is the 14th largest manager of defined contribution plan assets with more than \$64 billion of assets under management.

MassMutual commends Chairman Neal and the Subcommittee for its efforts to examine ways to improve pension coverage for all Americans. Pension plans and other retirement savings vehicles have over \$5.882 trillion in assets. While the assets in private sector defined contribution plans at \$3.49 trillion are now larger than those in private-sector defined benefit plans, IRAs have now become the single largest source of retirement assets in the United States at \$4.75 trillion. Since they were created in 1974, as part of the Employee Retirement Income Security Act of 1974 (ERISA), IRAs have served three principle functions. The first is to offer a retirement savings vehicle for individuals not covered by an employer sponsored retirement plan. The second is to provide portability to individuals changing jobs by allowing them to transfer, or rollover, plan assets from their former employers' retirement plan into an IRA. Finally, IRAs may be used as a simple employer sponsored retirement vehicle. In 1978, Congress created the Simplified Employee Pension Plan, or SEP IRA, that is an employer sponsored IRA. In 1986, Congress created the Savings Incentive Match Plan for Employees IRA, or SIMPLE-IRA, as a new form of simple defined contribution plan specifically targeted for small business. Since 1974, employers have been able to offer a payroll deduction IRAs. While MassMutual offers a variety of retirement plans and IRAs, in our experience, relatively few employers offer payroll deduction IRAs to their employees.

Notwithstanding the obvious successes of private sector retirement plans and IRAs, approximately 75 million workers, or about half of the private sector workforce, do not have access to an employer sponsored retirement plan. Most of these workers are employed by small businesses. While the reasons for this gap in coverage by small business are complex and multifold, the challenge it represents is significant and deserves additional consideration by Congress. One recent proposal is to create a payroll deduction IRA with automatic enrollment features similar to those now available in 401(k) plans. MassMutual applauds the Subcommittee for looking at this issue and, in particular, commends Chairman Neal for sponsoring H.R. 2167, "The Automatic IRA Act." For employees who are financially able to save for retirement, automatic enrollment will increase coverage rates, as has been demonstrated with auto-enrollment 401(k) plans.

MassMutual believes that one of the ways to increase coverage in private sector retirement plans is to offer employers simple low cost, low risk options, targeting small employers, and to remove a number of regulatory burdens that exist under current law. We believe that legislative changes can make it easier and more attractive for employees not participating in employer-sponsored retirement plans to contribute to an IRA offered through small employers. In seeking to improve the coverage for all Americans, it is important to keep the incentives in place for the employer sponsored system. We have concerns that if automatic IRA programs become widely used and are widely accepted as a low cost, low risk simple means of providing for retirement, some employers who currently sponsor more generous 401(k) type programs may terminate their plan and substitute an automatic IRA. More study is needed to be certain that an automatic IRA program does not have the unintended consequence of encouraging employers who currently sponsor plans to opt out of an employer sponsored qualified plan and substitute an automatic IRA because it is a less expensive alternative. Finally, 401(k) plan pre-retirement withdrawals are more restrictive than IRA withdrawals. Further study is needed to determine if this leads to excessive "leakage" of retirement plan assets.

We applaud the members this Subcommittee for its historic leadership on retirement issues. Moreover, we thank the Subcommittee for taking time to consider what can be done to increase the retirement coverage for all Americans. We look forward to working with the Subcommittee as it further considers the coverage issue.

Dear Representative Neal and Representative English:

Thank you for holding a hearing on the role of individual retirement accounts in our retirement system. Long-term financial security is a cornerstone of the American dream. Yet today, this dream is at risk. According to the 2008 Retirement Con-

fidence Survey, Americans' confidence in their ability to afford a comfortable retirement has dropped to its lowest level in seven years.

Several factors have contributed to this crisis. First, traditional pensions have been disappearing: less than 20 percent of the private sector workforce is currently covered by a traditional guaranteed pension plan, and this number is declining rapidly. The current personal savings rate is at its lowest level since the Great Depression. Of course there is Social Security, but that program was designed to provide a floor of income—it was never intended to be the sole source of income for people who have retired.

Seventy five million workers, about half of today's workforce, don't have a retirement plan at work—no pension, no 401(k), and no profit-sharing plan. In fact, certain groups are less likely to have access to workplace savings than others. For example, Hispanic and African-American workers are significantly less likely than white workers to have an employer that offers a workplace retirement plan.

Even among the minority of American workers who are saving for retirement, most are not saving enough to maintain their standard of living. According to the 2008 Retirement Confidence Survey, one-third of workers who have saved for retirement report having less than \$25,000 in savings, excluding the value of their home and any defined benefit plans.

Our groups believe that Americans need to have the tools and the opportunity to achieve life-long financial security. We need to make saving simple and effective for all Americans. All of us deserve the peace of mind to know that even if we don't have a pension plan at work, there is a simple and easy way to put aside money for retirement through payroll deduction.

This hearing is an important first step. We need Congress to pass H.R. 2167, the Automatic IRA Act of 2007. The auto-IRA is a simple, low cost way to provide employees with something of their own—a real retirement savings tool. In exchange for offering the auto-IRA, employers will receive a tax credit that will help cover the cost of administering the plan. The bill will help small businesses to be more competitive with many large and medium size companies in recruiting and retaining employees since many already offer their employees retirement saving tools.

With an auto-IRA, there are two simple choices for workers to make—how much do they want to contribute to retirement and what kind of retirement account they would like to have. Of course, workers could choose not to participate. The auto-IRA also allows workers to invest in accounts and take that account with them if they change jobs.

Currently, too many Americans have little hope of having enough money set aside for a secure retirement. For these people, retirement is a source of major insecurity. Congress can help by passing H.R. 2167, the Automatic IRA Act of 2007 and provide access to workplace retirement savings for millions who currently are not covered. Thank you for your efforts on this issue.

Sincerely,

AARP

Business and Professional Women

Consumers Union

National Council of La Raza

Women's Institute for a Secure Retirement (WISER)

